LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

OCTOBER 24, 2007

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LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES

Wednesday, October 24, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:06 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Gutierrez, Watt, Sherman, Meeks, McCarthy of New York, Miller of North Carolina, Green, Cleaver, Bean, Moore of Wisconsin, Davis of Tennessee, Perlmutter; Bachus, Baker, Pryce, Castle, Royce, Manzullo, Biggert, Shays, Miller of California, Capito, Feeney, Hensarling, Garrett, Brown-Waite, Barrett, Neugebauer, Price, Davis of Kentucky, McHenry, Campbell, Bachmann, Roskam, and McCarthy of California.

The CHAIRMAN. The hearing will come to order. I apologize for being late. I had a problem this morning picking up my cleaning. And when I complained, the cleaner told me that it was the fault of Congress because they couldn't get good workers. So, I apologize, and I'm looking for a new cleaner.

This is a very important hearing, and I am very appreciative of all the work that has gone into it. I want to thank all of the witnesses. Every one of the witnesses today has either in person or through his or her organization been a very constructive participant in this discussion about what to do.

And I want to say this: We have, I think, a very important piece of legislation, and I believe that it is important for us to pass this before we adjourn. And the good news for people who worry about hasty legislation, not necessarily good news for everybody's family, is that the majority leader has just announced that we will be meeting on the 4th, 5th, and 6th of December and the 11th, 12th, and 13th of December. So we have some time, and we're going to be pushing back some of the markup on this.

I want to say two things: I think it is very—don't look at me, Gresham, it's the majority leader's fault. I am very much convinced that we will pass a bill out of third party that is very much like what has been introduced. I am also convinced that it will not be exactly what has been introduced. This is not an area where dogmatic certainty behooves anybody. We are dealing with some new phenomena. We are dealing with a relatively new financial phenomenon, and that's really want I want to talk about today. I want to really just set here the conceptual framework.

We have seen in the past 10 years or so, maybe more, great changes in the way mortgages are originated. Innovation in the financial sector is of course very important, and we should be clear. Innovation does not lead to deeply rooted new practices unless it's of value. There are innovations that wither and die because they don't serve a real function. What we have in the mortgage area are a set of innovations—basically origination by people outside the banking system—by brokers not working for banks, accessing pools of money that are not subject to deposit insurance.

And we then have the phenomenon of the secondary market. I want to be very clear. I regard both of those as very good things. These are positive and beneficial additions to our ability to finance housing. The problem is not within innovation, because I think there's a self-correcting here. If the innovation doesn't serve a positive function, it does not survive in our market economy.

The problem is that there is an inevitable tendency for innovation to outstrip regulation. That's why they call it innovation. And our job is to have a regulatory framework that keeps up with the innovation in a way that allows the benefit and the value of the innovations to flourish while providing the safeguards against abuses that it's the job of regulation to do. I believe that we have seen much more of a problematic level of activity in the unregulated than in the regulated sector of mortgage origination.

It is not because the people doing the origination in the unregulated sector are morally inferior to those in the regulated sector. I think that morally most people are good, but there are some people who are abusive. The problem is that we have in place with regard to banks and credit unions a set of regulations enforced reasonably by regulators which hold in check some of the abusive practices, and we don't have that in the unregulated sector.

And so the first part of our job is to extend in general the kind of regulation that has served us well, in my judgment, in the regulated sector, to the unregulated sector. And that means you allow the process to flourish, but you try to prevent abuses.

The other area that we deal with here is the secondary market. The secondary market has been very important. It has clearly provided increased liquidity, and that means more money for people to buy homes and live in their homes. But, as with any other phenomenon, it has a potential for abuse. And in particular, and I quote Ben Bernanke here, what he calls the originate-to-distribute model, provides increased liquidity but it also diminishes responsibility.

The regulatory framework provided responsibility. Banks that lent money to people when they shouldn't have, and who were visited by the representatives of some of the people at this table who said that really was not such a good idea; don't do it again. And in effect, what we're trying to do is to replicate that in the other area.

But you also have in the secondary market the problem that the lack of responsibility that could exist at the origination level could then be passed along. And I know there are people who have said that if we do anything to the secondary market in any way to increase any kind of regulation, we will destroy it. The notion that even a reasonable and mild form of regulation is somehow fatal to any kind of market activity is a frequent argument.

As I said before, people who want to read it and experience it at its fullest should go back to the Congressional Record of the 1930's and read the debates about the establishment of the Securities and Exchange Commission when the country was told that sort of regulation would kill the market.

Indeed, we are now in a situation in which one of the problems in the market is a lack of investor confidence. We have added overreaction here. People went from being too sanguine about some of this paper to being much too negative about it. I believe that rules that give the investor some better assurance that what they are being offered has a certain quality to it that is market enhancing, not market destroying. And if we do it right, we can help restore investor confidence and that obviously is a very important issue.

So we have a form of increased responsibility not on the ultimate investor, but on the securitizer, the people who actively package and sell this, because those are people whom we believe can be charged with some additional duty to make sure that what they are selling is material that should have been done in the first place. And I was pleased to see that Chairman Bernanke has agreed that some of this is done.

Now I understand there are people who say we should do nothing. We should be very clear. We are now in the most serious financial crisis the world has seen since the late 1990's. I believe it will be one that we will surmount. I don't see terrible disaster looming, but we are in a serious crisis. It is inconceivable to me that we, the Congress, and the regulators working together, would do nothing to diminish the likelihood of a repetition of some of these abuses. The innovations in the mortgage market have produced a lot of new homeowners, which has led to a degree of financial crisis far beyond what anybody expected.

And I think there was—I didn't see a lot of people predicting that the subprime crisis was going to spill over into the mortgage market in general, that jumbo mortgages would be in trouble. I didn't see many people predicting that the mortgage crisis was going to spill over into the financial market at large. I know there are people who now say that they knew this was coming all along. I am waiting for the e-mails in which they made that statement dated sometime ago. Apparently, all of those e-mails were purged, because while a lot of people now tell me they saw it coming, I don't remember anybody telling me they saw it coming when it was coming. And I think the very fact that we were taken by surprise, all of us, to the extent that we were, is one argument for doing some things and putting some things in place that have to be done.

To summarize, I believe that—and I'm very grateful. We have had a very participatory process. We will be marking this bill up probably in a couple of weeks. It's an intensive period but it is, I think, a high priority for members. I do expect, as I said, that the basic outline will be preserved, but we have some specifics where people will be discussing things.

There are additions. The chairman of the Capital Markets Subcommittee has some very important additions that he has proposed. There are some proposals that were made in the testimony that seem to be very important. There are aspects of the bill introduced by the ranking member that are important, and I should say that 2 years ago at this time, the ranking member and I and our two colleagues from North Carolina were trying very hard to work out a bill. I wish we had been able to—I wish we had been allowed to go ahead. We might have avoided some problems.

But I think there is on both sides here a recognition of a problem. There will be some differences about how to resolve the problem. But there is and has been for some time a common recognition of a problem and the need to try to preserve a flow of mortgages while diminishing abuses. That's the job of this committee.

I will now recognize the ranking member. We're going to, because of the importance of this, take the full 20 minutes on each side for opening statements. So there will be 20 minutes of opening statements on each side. I plan to be here all day. I have cleared my calendar. It will be a long day, but it is very important that we do all this, and the other members will be free to come and go. Their staff members will be here. I believe this is a hearing which will have a major impact on what we do.

The gentleman from Alabama.

Mr. BACHUS. Mr. Chairman, I appreciate you holding this hearing. The testimony of the witnesses will be helpful to us as we consider measures to curtail predatory practices going forward to ensure that mortgage credit remains available for those subprime borrowers who are worthy of it and have the ability to repay it.

The committee has a history of coming together in a bipartisan way to address serious issues, and I hope that will be the case in this regard. I will say that the role of Congress is not to either insulate or bail out borrowers or investors or lenders when they make bad decisions. And that's whether or not you're talking about someone borrowing for a home or a large financial institution. I hope that whatever we do, we don't end up with a taxpayer-funded bailout or a taxpayer guaranteed result.

There has been some recognition, I think, by all of the members for some time that we needed to move and eliminate predatory lending. For that reason, last July, several committee Republicans and I introduced a subprime lending reform bill to combat abusive practices and to encourage greater accountability and transparency throughout the mortgage industry.

In taking action on this matter, our goal should be to correct existing problems if we can, while not creating new problems. Let us not forget that subprime lending has made it possible for millions of low- and middle-income families to purchase homes. Even after the events of the past several months, 85 percent of subprime borrowers are making timely payments and enjoying significant benefits of homeownership. There has been talk about many of them, their mortgages will adjust in the future, but the market is already anticipating that, and many of the lending institutions are working with the borrowers on a one-to-one basis and adjusting the contracts, and I applaud that.

I think that's primarily how we're going to deal with this going forward is for borrowers and lenders without the interference of the Congress or the government in the process. That's always of benefit to everyone, because it's never—we have said this in many, many hearings; foreclosure is never in the best interests of a lender, a borrower or an investor. And that ought to be a strong motivation for all of them to get together. When the Congress gets involved, they sometimes only complicate things. As I said earlier, when the government gets involved, it usually is at taxpayers' expense.

Preserving the dream of homeownership and access to credit makes the dream possible and should be a high priority as we work together on legislative responses. And we do need to appreciate the fact that when there are foreclosures in neighborhoods and communities, it not only hurts the homeowner, it not only hurts the lender and the investor, but it also hurts those communities. It's essential that we be sensitive to the plight of homeowners facing sharply higher payments as their adjustable rate mortgages reset. And we should be especially mindful that any new limitations we impose on mortgage lenders do not make it less likely that families can refinance their mortgage loans with more affordable financing. I think the action of the House Judiciary Committee and their bankruptcy legislation very much is going to threaten the availability of lending going forward.

As we evaluate legislation, we should consider carefully how similar legislation on the national and State level in the past has affected the availability and affordability of credit to those who need it most. We need to determine whether the laws on the books today have had their intended effect, or whether in some instances they have actually harmed the low- and moderate-income families that they're designed to help.

The data on this subject has been studied and interpreted by a number of industry and consumer groups as well as academics. Their conclusions vary greatly. Hopefully our testimony from the witnesses will bring some clarity to that subject. In this regard, I'll mention that North Carolina—and we've talked about the North Carolina bill, and Title 3 of this legislation adopts the North Carolina model. But I will say that in many North Carolina towns, the amount of mortgage foreclosures and predatory lending loans is significantly higher than other places in the country, and one wonders how a law which even I have said has many good provisions, it certainly hasn't prevented predatory lending in the past.

As legislators, while the conclusions we make and the actions we take have far greater weight than the reports of those who simply analyze the data, we have both the privilege and the responsibility of acting in the public's interest. That responsibility is particularly great when the things we do affect the hopes, dreams, and basic needs of all Americans.

The legislation before us, like all regulatory interventions, requires a balancing of interests. The competing values in this case, the availability of credit on one side, and protecting borrowers from sharp practices and unethical conduct on the other. Our task is to strike an appropriate balance between these costs and benefits. The testimony of the witnesses will help us judge where that balance lies.

At this time, Mr. Chairman, I'd like to recognize the gentlelady from Illinois for 3 minutes.

The CHAIRMAN. The gentlewoman is recognized.

Mrs. BIGGERT. Thank you, Mr. Chairman, and thank you for holding today's hearing. I would like to welcome our distinguished witnesses. After 9 months and 6 hearings and one resolution addressing the subprime and foreclosure issues, I'm glad that we have reached this day.

As we proceed, I'd like to outline a few items that I would urge my colleagues to take into consideration, first, do no harm. Our committee should aim to preserve access to credit and homeownership opportunities for qualified low- and middle-income borrowers.

While we work to protect homeowners from unscrupulous practices, we should not, for example, characterize all subprime loans as predatory. Of the 68 million American homeowners, 50 million hold mortgages, and 13 million of them are subprime mortgages, and approximately 750,000 homeowners with subprime loans are in foreclosure. This number is expected to rise to millions next year, but we must keep in mind that the majority of homeowners will keep their homes. One or more of today's witnesses may utter the phrase, "Don't throw the baby out with the bath water," and I couldn't agree more.

Second, I would like to see as a final product here is one that facilitates transparency in the mortgage market, creates a level playing field, promotes strong underwriting standards, and fosters competition. Achieving these objectives is important for both the primary and secondary mortgage market participants. It's a win for all consumers, lenders, and investors if they more clearly understand the loans. Bad actors and bad products are more likely to fall by the wayside. Liquidity and credit will expand, and homeownership is sure to flourish. I hope we will look at including the issues of mortgage fraud and financial counseling in a bill.

And third, I'd like to thank the chairman for his comments today in Politico, in which he was quoted as saying that everything is negotiable. And while I must say I have never before heard him admit that he is not the emperor, I nonetheless appreciate the sentiment behind his quote and look forward to working with him. It's important for future American homeowners and the economy that we put political agendas aside and get this right. Too much action and we worsen the problem. Too little action and we allow it to happen again.

So I look forward to working with my colleagues on both sides of the aisle to craft common sense and balanced legislation. Thank you, and I yield back.

The CHAIRMAN. Before I recognize the chairwoman of the subcommittee, I would just say to my colleague from Illinois that if I were the emperor, it is certainly was a good thing that I went to the cleaners today.

Mrs. BIGGERT. Yes. You must have clothes.

[Laughter]

The CHAIRMAN. The gentlewoman from New York is now recognized.

Mrs. MALONEY. Thank you, Mr. Chairman. And I want to congratulate you on the introduction of this ambitious and comprehensive bill and to welcome the witnesses that will help us refine it.

This bill clearly demonstrates the intent of the chairman and Democrats in the House to address the subprime crisis in a thorough and effective way. Over the course of this congressional session, we have held a number of hearings in my subcommittee and in the full committee on the critical problems posed by the meltdown of the subprime mortgage market.

Those hearings made it clear that this is a many-headed Hydra of a problem, and that we need to be careful that as we chop of one head, a new, more vicious one does not sprout in its place. Early in this process, one mortgage banker said to me that any solution must change the incentives of all market participants. I came to fully appreciate why that is true through the testimony I heard and the hearing record that we put together.

This is not a problem that can be blamed on a few rotten apples among brokers or mortgage originators. It is not a problem that can be laid at the doorstep of any one sector, whether it is the securitizers, the secondary market, or the primary lenders. Regulators failed to act, but past Congresses also failed to pick up on the failure.

This bill attempts to change the incentives of all participants across the board. For that, it is a bill that the Democrats can be proud of. Like many bills that attempt to tackle so many aspects of one problem, it has many rough edges, some of which members have already noted, and we will be working on it through the legislative process to smooth that out. I, for one, plan to listen carefully to the comments of all stakeholders, consumers and to see what tweaks might be needed or added.

This hearing is the first in that process, and I look forward to the testimony.

The CHAIRMAN. The gentleman from South Carolina is recognized for 2 minutes pursuant to the list I have been given by the ranking member.

Mr. BARRETT. Thank you, Mr. Chairman. To our distinguished panel, thank you for being here. I think we can agree on a couple of basic things. One, that those bad actors who engage in illegal acts should be punished, and laws against fraudulent activity in the mortgage market should be enforced.

I think we can also agree that lenders are making loans that they should not make, and people are borrowing money that they probably can't pay back. I also think that many homeowners out there should be afforded the access to credit as long as they can pay their loans back.

However, we may disagree on one basic point. I believe that the free market does the best job of providing affordable and accessible products. And I do think that includes mortgages. Through legitimate innovation in the private mortgage market, more people are able to get mortgages at lower rates than ever. And I can't deny that there have been some major problems, and there's some need for some short-term help. But long term, these are better remedied through the natural market actions and targeted regulations, both of which we've started to see. I think it would be a major mistake to shift this market through excessive and rushed regulations which may likely lead to unforeseen consequences.

I wonder if the consequences that the majority party has expanded the government's role in the mortgage market, at the same time they want to make it exceedingly difficult for the private mortgage lenders and brokers to conduct business. While we do need to ensure that customers are protected by making sure that their mortgage practices are transparent and reasonable, and that fraudulent activities are punished, we cannot afford to regulate the subprime mortgage market out of existence, and make it so that less wealthy borrowers can only borrow from one lender—the Federal Government.

As a former small business owner, I can personally attest to the power of relationships when providing credit. I was a small furniture dealer. And there's a lot of power—a lot of power—in looking somebody in the face and shaking their hand. In many cases, that's much stronger than a contract. Something tells me our Federal Government won't be able to quite provide that same service to our homeowners.

I look forward to your testimony. I look forward to working on a bill that keeps all this in mind, and I yield back.

The CHAIRMAN. The chairman of the Subcommittee on Capital Markets is recognized for 3 minutes. Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman. Mr. Chairman, I would like to congratulate you and many of the fellow members who have taken the time to work on H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act. It contains a number of new provisions that I sought to address in the last Congress, including broker licensing reforms and anti-steering mandates.

As we proceed with this consideration, I will be focusing most of my attention on the provisions related to assignee liability, which is within the jurisdiction of the Capital Markets Subcommittee, and the need for these new national standards to apply uniformly across the country. I have also introduced H.R. 3837, the Escrow Appraisal and Mortgage Servicing Improvements Act, to address many issues not outlined in H.R. 3915, but which also contribute to problems in the mortgage lending marketplace.

The problem of abusive and deceptive lending is complex, and it requires a comprehensive solution. H.R. 3837 should be part of any solution that the Congress considers. H.R. 3837 also has attracted broad support. Some of these parties include the Center for Responsible Lending, the National Association of Realtors, the National Community Reinvestment Coalition, the Appraisal Institute, and the National Alliance of Independent Mortgage Bankers, among others. At this time, I ask unanimous consent to insert into the record statements from the Realtors, the Appraisal Institute, and the National Alliance of Independent Mortgage Bankers on these proposals.

The CHAIRMAN. Without objection, it is so ordered.

Mr. KANJORSKI. Mr. Chairman, I have listened to several of my colleagues, and I sense a bit of fear, on the one hand that we are going to move too excessively with regulatory order, trying to create or establish stability out of chaos. And on the other hand, a fear that the majority party is going to be doing something that has been undone in the past.

The reality is, this committee and the Congress has been struggling for many Congresses to get our hands around predatory lending. We have had some good bills. I have had the occasion to sponsor those bills with colleagues on the other side of the aisle, and

I think if in past Congresses we had seriously moved on those pieces of legislation, perhaps some of the problems we face today would have not have come to fruition.

However, all that being said, we do have a serious problem. It ranges from being a problem that can be solved, to some people saying it could be catastrophic in result. In either regard, it is essential that we provide the rules, regulations, and guidance to the financial services industry of this country to be certain that any damage that is already done has an opportunity to be corrected, and to prevent future damage.

I look forward to these hearings, in order to see how we can come to a consensus. As our ranking member indicated in his opening statement, that is what this committee needs, and that is what this Congress needs. This is a problem that faces America, not Republicans and Democrats, not working people or businesspeople, but all of us, because it is so substantial to our very existence as citizens.

So I congratulate you on these hearings and I yield back the balance of my time.

The CHAIRMAN. The gentleman from California, Mr. Campbell, is recognized for 2 minutes.

Mr. CAMPBELL. Thank you, Mr. Chairman. As you indicated earlier, the broad problem that we're dealing with here is actually a problem of the entire economy. This crisis, this lending crisis is clearly bleeding into other parts of the economy and has slowed our economic growth and potentially threatens a recession. So this is not just about this lending, but this is about what we're doing to try and keep the economy growing, rather than see the economy falling into shrinking.

Part of the solution clearly is that people who want to buy homes, people who want to restructure their financing, people who want to refinance, have the ability to do so, and that the credit markets, which are now very, very tight and have tremendous risk premiums, become loosened up, and that those risk premiums go down. Now this does not clearly mean that we want to go back to the bad practices that got us into this problem in the first place. But we clearly need to be fostering legislation here that restricts those bad practices while allowing the vast majority of lending to occur and to actually occur more frequently than it is today right now.

My concern is that this bill could move us farther away from that goal rather than closer to that goal. Arguably, the people who engaged in the bad practices are already paying a pretty high price. There are a lot of people who are now—companies that are now bankrupt. There are a lot of banks and big financial institutions reporting significant losses. But still, some regulation in this area, I think, makes sense to ensure that we don't do this sort of thing again.

But provisions out there that would cause lenders not to lend, or originators not to originate, or securitizers not to securitize, because of potential downstream liability, or because of restrictions on legitimate loan packages, would not be wise, in my view, and would not move us towards an eventual goal of enabling people to borrow money so we can keep houses selling and this economy moving.

I look forward to hearing the testimony of all the witnesses and look forward to working together to ensure that we have a bill that moves us towards the solution and not away from the solution. With that, I yield back.

The CHAIRMAN. The gentlewoman from California, the chair of the Housing Subcommittee.

Ms. WATERS. Thank you very much, Mr. Chairman. I, too, would like to congratulate you for holding this hearing today, and I am very, very pleased to co-sponsor the Mortgage Reform and Anti-Predatory Lending Act of 2007, in significant part because I know how painstaking and consultative the process was that generated it.

The subprime crisis is large, complex, and far from over. Its impact has been felt nationwide, but not equally distributed across the country. Simply put, Californians—California joins the rust and sun belts at the center of the foreclosure wave. Foreclosure rates in California rank third in the country and are 99 percent higher than the same time last year. Meanwhile, as many as 1.5 million subprime adjustable rate mortgages carry the potential for serious financial distress by 2009. H.R. 3915 is designed to make sure this doesn't happen again.

In that sense, we are here today to talk about prospective actions, not necessarily solutions to the current crisis. But the two are clearly linked. I'm concerned that as little as 1 percent of the at-risk subprime loans have been modified by services to date, despite highly publicized initiatives. Congress is limited in its ability to require the mortgage industry to clean up the mess they made in a largely unregulated environment, but the industry's track record should inform our assessment of any claims they make today and going forward to having the ability to prevent and address future messes absent significant Federal regulation.

This said, a delicate balance must be maintained between protecting borrowers on one hand and encouraging innovation in mortgage lending and sustaining the critical secondary mortgage market on the other. H.R. 3915 strikes this balance. Perhaps the most important steps the bill takes are to impose a Federal duty of care on mortgage originators and minimum standards on all mortgages. It is clear to me that we need to prevent the now widespread practice of getting people into loans they can't afford. To that end, it's reasonable to require licensed originators to present consumers with mortgage loan products appropriate to their circumstances. Underpinning this must be some minimum standard regarding the borrower's ability to repay, which H.R. 3915 establishes.

I believe this is a sound standard to impose universally in the mortgage market. Indeed, regulated entities have long faced similar standards from their regulators. To prevent mass exodus from the mortgage markets, the bill limits damages to 3 times the originator's fee plus the consumer's cost. Similarly, although the bill for the first time creates securitizer liability, such liability is limited to recession—recision of the loan and consumer cost. The bill also creates a safe harbor for prime loans and private loans that meet reasonable documentation and underwriting standards.

Is this the perfect balance between rights and remedies? I don't know that any of us can know for sure at this moment, but I look forward to hearing from the witnesses today on that point.

In sum, this bill is about incentives, balancing incentives to innovate against incentives to go over the line and marketing inappropriate products to borrowers and then whisking the risk off to the four corners of the global economy. I'm particularly pleased that H.R. 3915 removes the most destructive of such incentives, severing the link between the compensation of the originator, whether a mortgage broker or other entity, and the terms of the loan. Minority borrowers have been disproportionately steered to costly loans in part because the fees such loans generate for originators are higher than more appropriate products. H.R. 3915 correctly prohibits this practice.

I thank you, Mr. Frank, for this hearing today, and I look forward to working with you to solve this problem.

The CHAIRMAN. Thank you. Just to let people know, there's a great deal of interest in this, and I think it is useful for people to know where the members stand, so we're going to probably go for another 20 minutes or so on opening statements. The gentleman from North Carolina is now recognized for 2 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman. I thank you for holding this hearing. And I agree with the chairman. We need to take steps to make sure that both borrowers and lenders who are going through this challenge in the mortgage marketplace are good actors, and that goes for both sides of the transaction. According to the latest economic forecast, the housing market is in the process of correcting itself. We're at a mid-market correction, which will be going on for, well, some say a year, some say more. And it's a question of how Congress should act, and the proper actions that Congress should take.

My concern is that the chairman's bill will harm the mortgage marketplace and make it further—increase the level of difficulty for those facing default and foreclosure now to refinance their way out of this, to actually get in a mortgage that they can sustain, and so they can stay in their homes.

I believe that with the assignment of liability, both in the secondary market and the so-called suitability standards, which allow trial lawyers to determine whether or not the mortgage broker gave them the best, most "suitable"—a very ill-defined term—as heretofore laid out, that those two elements will further constrict the marketplace, the lending marketplace, which has already been constricted.

Finally, the third element of the bill takes the North Carolina statute and nationalizes it. The North Carolina law has not been all good. I'll have some colleagues on the other side of the aisle say that it was. But we have not had the level of lending in North Carolina because of the law that we have in place on mortgages. I believe if the Federal Government puts a proscriptive element into what can or cannot be lent in the mortgage marketplace, we will be further harming those who are trying to get out of dire situations now. So, therefore, if this bill is passed, I believe it will deepen the trough of the mortgage challenge that we're facing and really potentially push us into a housing recession.

I think we have to have a very balanced view of how we move forward. I think we need to focus on relief for those currently facing default and foreclosure, and then long-term, better disclosure and a better understanding in the marketplace of what consumers are actually purchasing.

And so with that, I thank the chairman for holding this hearing, and I thank the ranking member for yielding.

The CHAIRMAN. The gentleman from Illinois, Mr. Gutierrez, for 3 minutes.

Mr. GUTIERREZ. Well, thank you, Mr. Chairman. I applaud your leadership on this issue. I want to declare my support for H.R. 3915. I'm proud to be an original co-sponsor of the bill, and I want to take a moment to thank Congressman Miller and Congressman Watt for their hard work on this issue over the years.

I was going to introduce legislation on this issue, but I had confidence that my colleagues and my chairman would bring forward a good and comprehensive product, and I was right. They have. I'm pleased that H.R. 3915 retains the basic provisions of the Miller-Watt bill in the last Congress. I'm also pleased that the bill creates a national mortgage originator database and establishes a minimum Federal minimum standard for originators without including an outright preemption of State law.

Having said that, I'm concerned that the standards required for meeting the definition of a qualifying State law lack specificity in several vital areas. For example, the bill mandates that State laws require mortgage originators to, "receive minimum training and undergo a background check before becoming licensed."

I believe we should specify the minimum number of hours of education and training originators must complete before being eligible for licensing. We should establish a minimum number of hours of ethics training prior to licensing, as well as an annual ethics training requirement to maintain a license.

I believe we should mandate a criminal background check with fingerprints prior to licensing similar to the standards introduced in legislation sponsored by Ranking Member Bachus. This type of background check will substantially increase the chances of a national database being an effective tool of weeding out bad actors in the industry. I believe the general approach to qualifying State law standards in H.R. 3915 invites mischief during the rulemaking process, and it leaves the door open for some States to even dilute their existing standards and still meet the definition of qualifying State law.

I think the bill states that originators are required to make full, complete, and timely disclosure, but fails to offer any guidance as to what qualifies as a timely disclosure. Is 2 hours before closing timely? Two days? We should give regulators more guidance in this area.

Finally, I'm not inherently opposed to capping remedies. But the remedies available to consumers must be substantial enough to effect behavior change in the marketplace.

I look forward to hearing from the witnesses, and I thank you all for coming this morning and being with us. And, again, I thank Congressman Miller and Congressman Watt, and, you, Mr. Chairman, for improving this bill as we move forward.

The CHAIRMAN. The gentleman from California, Mr. Royce, for 2 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. On the issue of assignee liability, I believe implementing assignee liability as is done in this bill would be an egregious mistake. If we can learn anything from the market turmoil over the last few months, we should understand that the problem in the subprime sector has impacted our capital markets and it has the potential to spur an economic downturn.

If assignee liability is improperly applied, players in the secondary market will simply reject the purchase of loans that expose them to potential liability that cannot be determined or quantified. The likely result will prevent many creditworthy borrowers from receiving financing, and the credit crunch will spread even further.

Second, as the Wall Street Journal points out today, this bailout gives delinquent mortgage borrowers a new trick to essentially enjoy free rent for up to 30 years if a borrower has to endure the sad experience of foreclosure, they'll have the ability to recover all of the principal and interest paid over the entire history of the loan as long as they can convince a court that they didn't have a reasonable ability to pay at the time the loan was originated. It doesn't take too much imagination to see how this could be abused.

The question I hope our witnesses address is, won't lenders be forced to raise rates for everyone to price this risk into loan products as a consequence of the provisions in this legislation?

Thank you. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas, Mr. Neugebauer.

[No response]

The CHAIRMAN. The gentlewoman from West Virginia, Mrs. Capito, ranking member of the Housing Subcommittee.

Mrs. CAPITO. Thank you, Mr. Chairman. I'd like to thank you for holding this hearing today on a subject that certainly has been at the forefront of our Nation for many months now, the subprime and credit crunch crises.

Every State and congressional district has been affected, some to a greater extent than others. States like California—and I would like to pause and say I know all of us in this room are very aware of what's going on in California, and our thoughts and prayers are with the citizens of California, and we hope that situation resolves itself. But States like California, Virginia, Colorado, and Florida have experienced significant problems, with many of their citizens utilizing alternative mortgages, who are now unable to afford the higher payments.

On the other hand, my home State of West Virginia continues to lead the Nation in homeownership and has had one of the lowest rates of foreclosure. There's no one single entity that caused this problem, and responsibility is shared by all relevant parties, and I'm sure this hearing will help shed some light on that.

Regulators were slow to understand the impact of designer loans. Lenders were overzealous in their lending practices. Many consumers were not fully aware of or did not comprehend the impact of their mortgage resetting at a higher rate. And Congress has been unable to act for fear of impacting a housing market that has been fueling our economy.

Today, despite increasing foreclosure rates and the forecast of more difficult time ahead, there are encouraging signs that both regulators and industry alike are taking steps to handle this crisis. It is my hope that we can work together in this committee to produce a prudent response to this problem. It is important to remember that while subprime lending practices have caused harm to some, they have provided many more with the opportunity of homeownership when they otherwise would not have had that option.

We must exert great caution to not over-legislate on this issue, and I've heard others express that concern, causing harm to those who have benefitted from this tool. This is a bipartisan problem that will need a bipartisan solution. And it is my hope we can build on the work done by the chairman, Chairman Frank, and the proposal that Ranking Member Bachus put forward earlier this year.

I welcome the input of our witnesses today, both on the proposals and their thoughts on the best way to address this problem. As the ranking member on the Housing Subcommittee, I look forward to working with the rest of the members of the committee on this important issue. And I want to thank the chairman for holding this important hearing.

I yield back.

The CHAIRMAN. Next, one of the co-authors of the bill, the gentleman from North Carolina, Mr. Watt. We are getting towards the end here.

Mr. WATT. Thank you, Mr. Chairman. The introduction of this bill a couple of days ago and the three panels that we will hear from today converts what has up to this point been largely a philosophical discussion to a discussion about a practical set of proposed solutions to problems that everybody recognizes exist.

In the philosophical discussion, there is broad bipartisan agreement. I have not heard anybody who supports predatory lending in that discussion. I haven't heard anybody who wants to dry up credit or make credit inappropriately more difficult. I haven't heard anybody who wants to reduce access to appropriate credit or homeownership. I haven't heard anybody who opposes financial literacy. I haven't heard anybody who opposes steering or who favors steering inappropriately in the market, and I haven't heard anybody who supports making loans to people who have not the ability to repay those loans.

That's the philosophical discussion in which we've been working, and our challenge has been to take that broad, philosophical discussion, those pious statements that we all say we believe in, and convert them into some legislative language that will accomplish the objectives that we say we support.

I'm hopeful that this legislation will take this philosophical discussion and convert it to a practical set of solutions, and I hope our witnesses today will really kind of get away from the broad, philosophical, pious statements that we've been making and really get into the guts of the bill and tell us what works and what doesn't work so that we can try to address the things that everybody agrees need to be addressed.

So, I'm looking forward to this. I thank the chairman. I thank Representative Miller in particular for being out in the front of this a long time ago. And I hope we can see some light at the end of this tunnel, and that the light is not a train coming toward us, but some real solutions to the problems that everybody acknowledges exist.

I yield back and thank—

The CHAIRMAN. Thank you. And now the other Mr. Miller is recognized for 2 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman. I appreciate you holding this hearing and Ranking Member Bachus for being involved in this, because it's long overdue. We've been talking about the problem in the real estate industry, subprime versus predatory for years.

When the marketplace existed as it did between 2000 and 2006, predatory wasn't a problem. When you have a person's home going up 15, 18, or 20 percent in value a year, and they're made a loan that they can make the payment because it's negative zero at first, and the trigger kicks in, in 5 years, and your house is worth $120,000 more than you paid for it, it's worth $320,000 rather than $200,000, it's easy to sell the home. So the people who were really kind of taken advantage of never really were in fact because their house was worth more when they sold it as we perceive it to be today.

The problem is, when you look at the marketplace and it's not increasing 15, 18, or 20 percent a year, and when you put your home on the market, it doesn't sell in the first 2 days, the people who have been taken advantage of are coming to light, and that's what we're seeing today. Predatory has been existing. It's no different last year than it was 6 years ago. The problem was there didn't appear to be a problem because the marketplace was continually rising.

Now we spent a lot of time focusing on GSCs. We were concerned about accountability and stability. I think we did a very good job. And if you look at the marketplace today, there's not a problem in the GSC marketplace. The problem that exists today is those people who were taken advantage of. When a lender goes out and makes a loan to somebody, that they know when the trigger kicks in, they cannot make the payment, they're predatory. The problem we have in the marketplace was that GSCs were limited in the amount of mortgages they could put on the marketplace in mortgage-backed securities, and so the private sector came in and bundled loans that looked very similar, but they weren't. They couldn't be debundled. When a GSC goes in default, they take it back. When the private sector did that, the guy who bought the mortgage-backed security is stuck.

This is long overdue. When you have lenders that don't acknowledge basic underwriting criteria when they make a loan, they're predators. Yet there's a tremendous amount of individuals making loans in the subprime marketplace that we have to ensure that are going to be viable and be there tomorrow to provide a service to those people who are not prime lenders but who need a loan and otherwise could not qualify for a loan. If we arbitrarily through legislation impact that marketplace, we're going to hurt the very people we're trying to help today. And I just urge caution in what we do legislatively. Yes, we need to define "predatory," and we need to get rid of the predators. But we need not impact those people who are trying to help in the subprime marketplace. Because if we overlegislate and we impact that marketplace, there's no place for them to go.

I commend you, Mr. Chairman, for this hearing, and I look forward to hearing the testimony today. Thank you.

The CHAIRMAN. Thank you. We will go to Representative Neugebauer for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I am glad to hear that the chairman said that we were going to probably push the market forward. One of the first things I was going to say this morning is I have felt like this process was moving too fast because it is too important.

One of the things that makes America probably so competitive is the fact that we have one of the most efficient capital markets in the world, and it is really one of the things that gives us an advantage.

I notice that the title of this hearing today is "Reforming Mortgage Practices." Certainly, I hope that is the movement that we move in and not overhaul. Really, we have a very efficient mortgage system today. It is the envy of the world. It has brought record homeownership. A lot of people have benefitted from our mortgage industry and the sophistication and the creativity that has come from it.

Yes, there are some folks who unfortunately ended up in mortgages maybe that they should not have been in.

One of the things that concerns me about the tenor of this hearing is we have heard people mention a lot of different kinds of mortgages, from prime to subprime, and then those people who are participating in what all of us think is egregious behavior, and that is predatory lending.

Let's not confuse the three. As we begin to go through this process, Mr. Chairman, I think it is important that we separate what parts of policy we are trying to address here.

The marketplace is in the process right now of trying to transfigure and try to figure out exactly what happened and how to fix this in the future. They are going through some painful processes. That is one of the things about a very efficient marketplace, that they are efficient but sometimes they are painful.

I would say that as we move forward, I think one of the things we have to say to the American people is we have confidence in them. If given the right information in the form of disclosure and transparency, the American public can make good decisions.

That is one of the things that I hope will come from this legislation as we move forward is that we figure out a way to bring the right amount of information to our consumers so that when they make sometimes one of the biggest decisions that they will make as a couple or as an individual of purchasing a home, that they are doing that with information.

What we do not want to do if these markets are trying to unravel and to bring liquidity back in the market is create some uncertainty in the marketplace that would make this somewhat of a blip in the marketplace even deeper than it is.

Mr. Chairman, regardless of how long it takes, let's not make political policy here. Let's make good policy.

I yield back.

The CHAIRMAN. The gentleman from New York, Mr. Meeks, for 2 minutes.

Mr. MEEKS. Thank you, Mr. Chairman. I want to thank you and Mr. Watt and Mr. Miller for having this hearing and working so hard on this bill.

We have to make sure that the wrong messages do not get out to the general public. I have talked to some individuals in my district, for example, and they are questioning whether or not they should buy a home.

I think the message still needs to go out there that in fact we do need to reverse the paradigm. I tell people in our district all the time, no longer should you just own the car and rent the house. You should rent the car and own the house, because over the long term, homeownership will be an appreciating asset and you can bet that car is going to be a depreciating asset.

That is educating individuals so they understand how important this is. What we were trying to do and I believe what this bill was trying to do is basically give some checks and some balances, if you will, so that we could make some of this confidence in individuals when they are going in to purchase these homes that in fact they can afford it.

It is very important, I think, for lenders, to also make sure that they are doing the right things. If someone cannot afford a home of a certain cost, they should not lend. I do not see how lenders benefit by foreclosing on someone's home.

What we have had is a situation whereas, for example, the economy heats up. Stocks heated up in the late 1920's, and dot-com's in the 1990's. Not for the first time, real estate in the 2000's.

Unfortunately, sometimes the commodity gets too heated and lenders and borrowers and everyone in between join forces and they end up making bad decisions, and eventually the roller coaster comes to an end.

I believe what H.R. 3915 will help to do is provide some of those checks and balances. Bill Clinton once said, "Mend it, don't end it." We are trying to mend it. That is what this does.

Finally, Mr. Chairman, I would like to add that I am hoping that in this legislation we can address a predatory practice that has flourished, I know definitely in my district, but I believe all across America, as a result of the subprime crisis known as equity stripping.

I am developing some legislation based on the existing State law and I hope that I can introduce some of the amendments and talk to the authors of the bill so that we can address this problem called equity stripping.

Thank you, Mr. Chairman. I look forward to working with you.

The CHAIRMAN. Thank you. We now have Mr. Hensarling for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. As interesting as our hearing is, there may be a more interesting one going on across the hallway, I note.

Clearly, the Nation is facing a bad situation. This committee has an opportunity to make that bad situation worse. I fear that we will embrace that opportunity.

We know about the threat of home disclosure. We know about the threat to the larger economy. We also have to take note that although Adam Smith's invisible hand is occasionally clumsy, it is certainly far more deft and skilled than the iron fist of the congressional mandate.

We still have to remember that millions of people have homeownership opportunities due to a subprime market. I am very leery of any legislation that could under cut that market.

Clearly, I believe that our government has a role to prevent force, to prevent fraud, to promote effective disclosure, not just voluminous disclosure, to promote financial literacy, and also to promote personal responsibility, and to remove barriers to market liquidity.

We should also take note about what is happening in the marketplace now. The market has a wonderful ability to correct itself.

New subprime originations are down and down significantly. Companies like New Century that had bad business practices have gone belly up.

Lenders all across America are reaching out to homeowners who may not be current to try to modify their loans and avoid disclosure. There is almost no player in the marketplace that wins under foreclosure.

As I look at this bill, although I do see some titles which I support, I fear that with a Federal duty of care, I fear that with subjective underwriting terms and subjective terms like net and tangible benefit to consumers, that at the end of the day, we may be replicating what we saw in North Carolina and Georgia, and we may have a trial attorney's dream and a homeowner's nightmare.

I yield back.

The CHAIRMAN. The gentleman from New Jersey for 2 minutes.

Mr. GARRETT. I thank the chairman. I thank all the members of all three panels for patiently waiting for your testimony that is about to come.

The chairman began his remarks with the investor confidence arguments to the need for government regulation and went back to the creation of the SEC and suggested that any argument therefore that was against it rang hollow then and supposedly any arguments against more regulation, I guess, rings hollow in the future as well.

The argument on the other side of that, of course, is history, the first we saw with SOX. There was the argument for investment confidence, for more regulation, and what did Congress do? We used a proverbial sledge hammer to hit something that should have just been hit down with a fly swatter instead. Same thing here. We see an over reaching approach for action by the Government.

I do not believe anyone is suggesting that we do nothing about this crisis. The facts are that things have already been done. As Jeb indicated, the private market has already stepped in. They have moved very quickly on this area.

The public sector has also moved and they continue to move with the Federal Reserve and they will be moving within the next couple of months by the end of the year as well.

Just on a little side note, I note that the Federal Reserve is taken out of this legislation altogether, and I am curious about that. I am wondering whether Ron Paul has had some influence on the chairman with regard to the Federal Reserve.

My last comment on this is that no one is suggesting that we do nothing. Action has already been taken. We do not want to do more harm than good. I think the wisest choice to take here is to move very cautiously and to do whatever we do in concert with the action that the Fed will take in the nearby future.

With that, I yield back.

The CHAIRMAN. The gentleman from Florida, our last 2 minutes.

Mr. FEENEY. Thank you, Mr. Chairman. I certainly agree with my colleagues, Hensarling and Garrett, in their last comments.

I want to suggest, rather than getting into details, that as we deal with this crisis as legislators, we remind ourselves of certain truisms in legislative processes.

Number one, the law's unintended adverse consequences. We try to do some good things and we do not think through the adverse consequences that may be much more harmful than any good we actually do in legislation.

I hope we do not do that with the crisis in our credit markets today. Related to that is Churchill's assessment that nobody with a heart was not a socialist when they were 20, and nobody with a brain was not a conservative by the time they were 40.

I hope at least part of Congress will act as adults as we respond to this crisis because we are very sympathetic indeed to the people who are losing their homes.

Third, I hope we will pay attention to the admonition that it is politically expedient but not good policy to concentrate the benefits for the few people in this case losing their homes, but to disburse the punishment, in this case, to the thousands of people who would like to sell homes but will have fewer buyers that can get credit, the thousands of people who would like to buy homes in the future but cannot get access to credit because we are increasing the risk.

Finally, I will note it is not just what this committee does, but I have begged and pleaded that the bankruptcy reform proposal which sounds great but could throw havoc into the credit markets combined with what we do here if we do not do it right could take a bad tumultuous credit situation and make it irretrievably worse.

We could take a recession in the housing markets and make it a depression across economic lines if we are not careful, because we are trying to do good, but not thinking about the real life economic consequences of thinking with our hearts and not our brains.

I hope we use at least part of our brains as well. With that, I yield back.

The CHAIRMAN. I thank the gentleman. I did listen closely to the gentleman from Florida. I would ask unanimous consent that the socialist writings of the gentleman from Florida and any other members at the age of 20 be inserted into the record. Without objection, we will await those.

Not hearing any objection, the record will remain open for those writings.

[Laughter]

The CHAIRMAN. I know we did not have e-mail then, Tom. Maybe you wrote a paper.

I appreciate the people waiting. It did seem to me important for the various members' viewpoints to be laid out, because we are about to deal with one of the most significant pieces of legislation that we will be dealing with this year, certainly from this committee.

We will now begin. Let me begin with Mr. Gruenberg, Martin Gruenberg, who is the Vice Chairman of the Federal Deposit Insurance Corporation. The Chair of the Corporation, Sheila Bair, who has been a very constructive participant with us in a lot of ways, unfortunately is ill today, and we are sorry to hear she is ill but we are pleased that Mr. Gruenberg on very short notice was able to come in her stead.

Mr. Vice Chairman.

STATEMENT OF THE HONORABLE MARTIN J. GRUENBERG, VICE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, ON BEHALF OF CHAIRMAN SHEILA C. BAIR

Mr. GRUENBERG. Thank you very much, Mr. Chairman. If I may also say that Chairman Bair really has provided very strong and constructive leadership on this issue. I do not think there is any issue that is of greater priority to her. I will try to do my best to sit in for her this morning.

Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for this opportunity to testify on behalf of the FDIC.

Let me say at the outset that while the troubles in housing and credit markets have yet to fully play out, they underscore the FDIC's long-standing view that consumer protection and safe and sound lending are really two sides of the same coin.

Poor lending standards and weak consumer protection are the root cause of the current problems resulting in serious consequences for consumers, lenders, and the United States' economy.

Clear balanced commonsense standards for mortgage lending practices will reinforce market discipline and ensure an adequate flow of capital to fund responsible lending, including for low- and moderate-income consumers with less than perfect credit profiles.

Legislation or regulation to address issues in the mortgage market should preserve the elements of the current system that have worked well for the economy and require all lenders to follow the same rules.

The Mortgage Reform and Anti-Predatory Lending Act is a workable and helpful vehicle for legislative action to establish a national standard. The bill would help ensure that borrowers receive mortgages that they can ultimately afford to repay, and that lenders in turn understand the credit risks they are taking.

Requiring mortgage originators to be licensed and registered will improve industry professionalism and prevent bad actors from jumping from one jurisdiction to another.

The minimum standards set by the bill include many criteria that have long been used by lenders to evaluate a borrower's ability to repay a loan. These include verified and documented financial information, taking into account all fees and taxes to be paid by the borrower, and underwriting loans based on the fully indexed rate, and assuming a fully amortizing repayment schedule.

A clear bright line standard for determining repayment capacity such as the debt to income ratio provision in the proposed bill will serve an especially important role by acting as a check on the significant portion of mortgage originators that are not subject to regular supervision.

Without a debt to income limitation, lenders could underwrite loans to the fully indexed rate, but at such a high percentage of a borrower's income, that the loan could not realistically be repaid.

The requirement that loans be fully documented also could be under cut without a debt to income standard that ensures a borrower's fully documented income can support the loan.

The provisions of the bill requiring the mortgage originator to disclose the comparative costs and benefits of mortgage loan products, the nature of the originator's relationship to the consumer, and any conflicts of interest will empower consumers to make better informed decisions about the products and services that are being offered.

Finally, it is important to address assignee liability as a meaningful check on abuse by originators.

Given the difficulties inherent in enforcing strong origination standards, it is appropriate that those funding the lending activity bear some responsibility for ensuring that the standards are adhered to by mortgage originators.

To be effective, however, assignee liability must be based on bright line standards so that it does not inadvertently dry up essential credit.

In conclusion, Mr. Chairman, the FDIC stands ready to work with Congress to ensure that mortgage credit is based on standards that achieve a fair result for both the borrower and the lender.

I would be happy to answer any questions the committee may have. Thank you, Mr. Chairman.

[The prepared statement of Chairman Bair can be found on page 143 of the appendix.]

The CHAIRMAN. Next, the Comptroller of the Currency—with whom we have had a very good and constructive relationship—Mr. John Dugan.

STATEMENT OF THE HONORABLE JOHN C. DUGAN, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. DUGAN. Thank you, Mr. Chairman. Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for the opportunity to testify on this important legislation.

The OCC supports the establishment of national standards for subprime mortgages, which have been the source of so many recent problems in credit markets. We also support the bill's goal of enhanced regulation of all mortgage brokers, whether used by banks or non-banks.

In recognition of pervasive problems in the subprime market generally, the Federal banking agencies tightened mortgage standards by issuing guidance on both subprime lending and non-traditional mortgages.

We believe these Federal banking agency standards addressed fundamental concerns about underwriting and marketing practices for these mortgages, but these standards apply only to federally regulated institutions. They do not address similar practices at State regulated institutions that are not banks, even though by nearly all accounts, such institutions engaged in some of the most aggressive mortgage practices.

As a result, the Federal banking agency standards cannot be truly effective unless they extend to non-federally regulated institutions as well, to create truly national standards.

Such national standards could be achieved through State action, Federal Reserve Board rulemaking, or Federal legislation such as the bill that is the subject of today's hearing.

Regardless of the path chosen, the OCC supports national standards for subprime mortgages similar to the Federal banking agency standards. From our initial understanding of the bill, which we have only had a limited time to review, it would establish national standards for three different categories of mortgages.

For all mortgages, the bill would establish national sales practice standards for mortgage originators through licensing and registration requirements, a Federal duty of care, and anti-steering provisions.

For subprime mortgages, the bill would through the use of safe harbor provisions establish national underwriting standards that are more stringent than the underwriting provisions in the Federal banking agency standards, and for HOEPA mortgages, the bill would lower the APR and fee triggers to make less costly mortgages subject to the enhanced HOEPA regulatory regime.

These three categories of changes plainly go beyond the Federal banking agency standards. That is some of the new national standards apply to mortgages other than subprime mortgages and some of the bill's national subprime standards are more stringent.

While we support some of these broader standards, others raise significant questions and concerns that we hope will be addressed as the process moves forward.

For example, the application of some of the new and extensive national mortgage standards to banks that do not provide subprime mortgages raises significant issues of regulatory burden and fairness.

In particular, we question whether the burden of the licensing and registration requirements for all bank employees involved in any type of mortgage origination is, given existing bank regulation, worth the marginal benefit, especially for community banks.

Likewise, the Federal duty of care and anti-steering provisions, which include highly subjective requirements that mortgages be appropriate and in the consumer's interest, will be difficult to enforce and could significantly increase the litigation exposure for all banks.

In addition, the more stringent underwriting standards for subprime mortgages would by definition restrict the availability of credit to subprime borrowers more than the Federal banking agency standards.

On the positive side, this reduction of credit would help ensure that the borrowers who obtain these loans could truly afford to repay them. On the negative side, the reduction would prevent some creditworthy borrowers from obtaining loans.

It is impossible to determine ex-anti the extent to which creditworthy borrowers would be denied loans due to the new and stricter standards. This is clearly a tradeoff in the bill.

In addition, the stricter standards would also prevent more existing subprime borrowers with adjustable loans today from refinancing such loans.

Finally, the OCC believes that there is an important point to be made about the bill's enforcement remedies. On their face, the remedies appear even handed because they apply equally to banks and non-banks, but the reality is quite different.

Because of existing enforcement provisions in Federal banking law, application of the same set of bright line standards to banks, brokers, and non-banks would in fact expose banks and their employees to a much wider range of potential enforcement actions than would be the case for brokers and non-banks.

Put another way, banks and their employees would be subject to a stronger enforcement regime than non-bank lenders or mortgage brokers for the very same violations of the bill's new provisions.

We urge attention to the bill's enforcement mechanisms to ensure that the bill's standards are as effectively implemented and enforced at non-bank lenders and brokers as they would be at banks.

Thank you very much.

[The prepared statement of Comptroller Dugan can be found on page 195 of the appendix.]

The CHAIRMAN. Next, another of the regulators we have been working with, John Reich, the Director of the Office of Thrift Supervision.

Mr. Reich.

STATEMENT OF THE HONORABLE JOHN M. REICH, DIRECTOR, OFFICE OF THRIFT SUPERVISION

Mr. REICH. Thank you. Good morning, Mr. Chairman, Ranking Member Bachus, and members of the committee. Thank you for the opportunity to provide the views of the Office of Thrift Supervision on H.R. 3915.

I applaud your efforts to address the need for enhanced Federal oversight of mortgage origination and funding process. I do believe that consistent and fair oversight of all players that originate and fund mortgages is overdue. While the problems of the current market are complex, the issues that created them are not.

To address these issues, we must adhere to certain key principles, including sound underwriting, transparency, strong consumer protection, a level playing field, and consistent supervision.

First and foremost, sound underwriting is fundamental to the success of mortgage lending. It protects both lender and borrower in the mortgage process. This fact alone highlights the importance of the effective oversight of the mortgage origination process.

We support the effort to require national licensing and registration of all mortgage originators who are not subject to Federal or State banking oversight. We suggest any national system should include adequate capitalization standards, competency testing requirements, and background checks for all principals and staff. Again, for mortgage originators that are not subject to State or Federal banking oversight.

Second, in addition to a Federal duty of care, I encourage the committee to consider modifying compensation incentives to mortgage originators, to consider a longer term pay out on loan origination, to protect the borrower customer's economic best interest. The typical compensation structure, for example, for life insurance agents might provide a good model.

Third, transparency is critical to the proper functioning of the markets. When market participants lack adequate information to evaluate their current positions or potential investments, markets break down.

Fourth, sound consumer protections are integral to promoting properly functioning markets. Just as market participants need accurate information to evaluate the markets, consumers need clear and balanced disclosures to be able to understand mortgage products.

We support the provisions of H.R. 3915 that promote clear and balanced disclosures for consumers in the mortgage origination process.

Consumer protections that address unfair and deceptive acts and practices in mortgage lending and other lending and financial service activities also make our markets stronger. This is the premise behind the OTS proposal on unfair and deceptive acts and practices that we issued in August.

For action in this area to be effective, however, it has to be applicable to all relevant players. With this in mind, we intend to work closely with the other Federal banking agencies at this table on how to address these issues following the November 5th comment deadline.

Effective regulation and oversight of the mortgage origination and funding process requires a level playing field for all market participants. We also appreciate the recognition of a safe harbor for certain loan products in this bill.

Based on our review and experience, these safe harbor loans are typically soundly underwritten and enjoy a high level of transparency with respect to their terms and occupy the most competitive part of the market. Hence, a level playing field.

A final point for your consideration in evaluating options for reform in the mortgage origination and funding process is joint State and Federal oversight of mortgage banking activities, such as that which currently exists in the supervision of State banks.

Establishing a partnership between the States and a Federal overseer to set and enforce minimum mortgage origination funding standards would ensure accountability and consistency throughout the mortgage lending process.

It is important to stress that a partnership would not necessarily involve establishing a Federal mortgage banking charter but rather impose a Federal/State partnership to regulate existing mortgage banking entities and ensure nationwide uniformity.

The OTS has extensive experience in overseeing and supervising mortgage banking operations, and I believe would benefit the current mortgage banking market.

I would be happy to share my thoughts on an OTS role in overseeing such a State/Federal national mortgage banking program.

In closing, I want to mention that mortgage foreclosures and possible solutions to the problem will be among the primary issues that will be discussed at the OTS' National Housing Forum to be held at the National Press Club in Washington, D.C., on December 3rd. Of course, you are all invited and we would be delighted if your schedules would permit that you could attend.

Thank you, Mr. Chairman. I would be happy to answer questions.

The CHAIRMAN. Thank you. Having attended last year's Forum, I regret that my schedule keeps me from going, but I would second your urging of the members. I found that very useful. Since the President's White House Ball will be that night, it would not be an extra trip to Washington. I would urge members to accept that invitation.

Next we have JoAnn Johnson, the Chairman of the National Credit Union Administration, another one of the regulators with whom we have had the privilege of working.

Chairman Johnson, please go ahead.

STATEMENT OF THE HONORABLE JOANN M. JOHNSON, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Ms. JOHNSON. Thank you, Chairman Frank, for this opportunity to testify regarding proposed mortgage reforms. This is a timely and important subject that merits congressional oversight, and I commend your interest in helping consumers make more informed and beneficial choices surrounding what is arguably the most important purchase they ever make, their home.

The credit union industry comprises a relatively small slice of the overall mortgage lending pie. Federally insured credit unions made about 2 percent of all mortgage loans in the first half of 2007 and 9 percent of mortgage loans made by depository institutions. Sixty percent of credit unions offer mortgage loans. Those that do not are generally smaller institutions lacking the infrastructure and expertise to manage a significant portfolio.

Federal credit unions also have a 10 percent loan to one borrower limit imposed by statute which makes mortgage lending less feasible for smaller credit unions.

Sixty-three percent of credit unions' mortgage loans are fixed rate. In the first half of 2007, fixed rate loans grew 14 percent while adjustable loans rose only 2 percent, a result of consumer reaction to a rising interest rate environment.

Non-traditional mortgage lending such as interest only or payment option loans while offered comprised less than 2 percent of first mortgage loans.

Earlier this year, we noted market trends suggesting greater prevalence of these products and we amended our call reports to specifically collect data and get a more accurate picture of the credit union activity. Mid-year results confirm NCUA's belief that credit unions have not delved very deeply into the kinds of alternative products that have made this hearing unfortunately necessary.

We believe that there are three primary reasons why these riskier loans are not widespread in the credit unions. First, as noted earlier, many credit unions lack the expertise and resources to underwrite these types of loans.

Second, over 2 years ago, we issued guidance addressing problems associated with both credit and interest rate risks in non-traditional lending. This translated into more stringent examinations.

Third, the Federal Credit Union Act prohibits prepayment penalties.

NCUA has proactively monitored trends and mortgage lending over the past decade and has issued guidance to the industry accordingly. As far back as 1995, NCUA in a letter to credit unions discussed potential pitfalls surrounding risk based and subprime lending.

In addition to our oversight of the financial side of the mortgage lending ledger, NCUA also takes a robust approach to enforcement of consumer protection laws through our examination process. Combined with careful review of member complaints, NCUA evaluates each credit union's compliance with the law and gains a more complete picture of how a credit union makes mortgage loans. We also issue regulatory alerts to ensure compliance with a full range of consumer protection laws.

This all contributes to a credit union industry that is enjoying relative stability in the midst of some very real dislocations in the mortgage market. While demand for mortgages remains high, delinquencies are low.

This brings me to the recently introduced legislation that will hopefully improve the mortgage lending menu by making choices more understandable while eliminating the abusive practices that have gotten some borrowers in dire financial straits.

The Frank/Watt/Miller bill addresses several practices in ways that contain very real positives for consumers. For example, making all originators subject to the same duty of care standards, requiring a determination of suitability, and eliminating unfair prepayment penalties, single premium credit insurance, and mandatory arbitration are important and sensible aspects of the legislation.

We also support the licensing and registration for mortgage originators who are not depository institutions. Further enhancements to HOEPA outlined in the legislation particularly regarding fees also represent a step forward.

I want to bring to your attention the omission of NCUA from joint rulemaking. There are several provisions in the bill that charge Federal financial institution regulators with writing regulations for the institutions they regulate.

Although credit unions are properly subject to this legislation, none of my colleagues at this table have supervisory or enforcement authority over them. NCUA is concerned that important aspects of credit union operations, as well as appropriate regulatory distinctions, would not be accounted for in the writing of the rules if NCUA is not jointly involved.

I respectfully ask that you consider amending the legislation to include NCUA in the process.

Congressman Kanjorski also has introduced a bill addressing other aspects of the home mortgage lending industry. NCUA commends that effort as well, particularly the aspects that improve consumer disclosures and transparency related to mortgage servicing.

In conclusion, I would like to comment on a fundamental element of any discussion on mortgage lending facing consumers, the need for increased financial education, and while it is not a panacea or substitute for rigorous regulation, I believe that all of us have a responsibility to promote a more financially aware borrowing public.

Thank you very much.

[The prepared statement of Chairman Johnson can be found on page 206 of the appendix.]

The CHAIRMAN. Thank you. Next we will hear from Randall Kroszner, Governor, Board of Governors of the Federal Reserve System.

Governor Kroszner?

STATEMENT OF THE HONORABLE RANDALL S. KROSZNER, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. KROSZNER. Chairman Frank, Ranking Member Bachus, and members of the committee, I appreciate the opportunity to appear before you today to discuss recent problems in the subprime mortgage market.

The recent increase in foreclosures has created personal financial and social distress for many homeowners and communities. Congress is appropriately concerned about these developments as is the Federal Reserve Board.

Promoting access to credit and sustainable homeownership are important objectives and the Board believes responsible subprime mortgage lending can help advance both goals.

In carrying out its consumer protection responsibilities, the Board believes it is extremely important to strike the right balance by seeking to protect consumers from predatory practices without restricting credit from responsible lenders to borrowers with shorter or lower rated credit histories.

Consumer protection laws take two different but complimentary approaches. One focuses on disclosure and the other on development and enforcement of substantive protections that prohibit particular practices.

To be effective, disclosures must give consumers the information that they can readily understand at a time when the information is relevant. To that end, the Federal Reserve will propose improvements to the rules governing mortgage disclosure and the timing of those disclosures.

The Federal Reserve is keenly aware, however, that disclosure may not be sufficient to combat abusive practices. We share the concerns of Congress that certain lending practices may have contributed to the problems we are seeing in the subprime market today.

Therefore, the Federal Reserve plans to exercise its rulemaking authority under the Home Ownership and Equity Protection Act, HOEPA, to address unfair and deceptive mortgage practices.

We plan to propose rules by the end of this year that would apply to subprime loans offered by all mortgage lenders. We are looking closely at practices such as: One, prepayment penalties; two, failure to offer escrow accounts for taxes and insurance; three, stated income and low documentation lending; and four, failure to give adequate consideration to borrowers' ability to repay.

Enforcement of consumer protection measures is also critical to protecting consumers from irresponsible or predatory lending. The regulatory scheme for the mortgage industry has become extremely complex and some mortgage lending extends beyond the Federal banking agencies' oversight.

This underscores the importance of collaborating with the State banking agencies and other organizations to address concerns in the subprime mortgage lending market.

To this end, we have launched a cooperative pilot project with other Federal and State agencies to conduct reviews of non-depository lenders with significant subprime mortgage operations.

Congress is appropriately concerned about the problems in the mortgage market. As with the regulations, I believe it is important that new laws carefully target lending abuses without unduly restraining responsible lending. Getting this balance right is particularly critical now as many borrowers are facing adjustments and may need to refinance into more affordable loans.

The bills before this committee would provide for a nationwide registration and licensing system for all mortgage brokers that would help limit the ability of bad actors to move to a new State after having run afoul of regulators in other States.

Legislation would also address concerns about loans made without consideration of a borrower's ability to repay. The Board firmly believes that lenders should give due consideration to the borrower's ability to repay a loan before the loan is extended, so long as the rules are flexible enough to allow creditors to consider pertinent factors and individual circumstances of particular consumers and to innovate prudently and fairly.

The bill would hold securitizers and loan purchasers liable for bad actions of mortgage originators. The securitization market is critical to increasing the resources available to fund home purchases and great care should be taken to ensure that investors in securitization markets can quickly and accurately assess and mitigate the risks, including compliance risks, of mortgages sold in this market.

Finally, the bill would ban abusive practices for HOEPA loans, such as prohibiting the financing of single premium credit insurance, an important thing to be done.

The bill would also extend HOEPA's protections to more loans by amending HOEPA's cost triggers. These potential actions merit discussion, and we welcome the opportunity to continue to work with congressional staff and Members of Congress on these and other provisions of the new bill.

I thank you very much for the opportunity to appear before you. I look forward to your questions. Thank you, Mr. Chairman.

[The prepared statement of Governor Kroszner can be found on page 226 of the appendix.]

The CHAIRMAN. Thank you. There are two votes, but we will finish the testimony from Commissioner Antonakes, and then we will take a break and come back and begin the questioning.

I am very glad to welcome my State Banking Commissioner, Commissioner Antonakes.

STATEMENT OF THE HONORABLE STEVEN L. ANTONAKES, COMMISSIONER, MASSACHUSETTS DIVISION OF BANKS, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. ANTONAKES. Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the committee.

My name is Steven Antonakes and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. I am also the State voting member of the FFIEC and a founding board member of the State's nationwide mortgage licensing system. It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors.

Chairman Frank, we commend you for holding this hearing today on these important issues. CSBS supports the direction of the Miller/Watt/Frank bill and looks forward to working with you and your staff as we move towards mark-up.

This morning, I would like to leave you with five points from my testimony. First, 10 weeks from today, our nationwide mortgage licensing system, 4 years in the making, goes live. The system seeks to improve the efficiency and the effectiveness of the U.S. mortgage market, to fight fraud and predatory lending, to increase accountability among mortgage professionals, and to unify and streamline State licensing safeguards.

On January 2, 2008, Massachusetts will begin using this system to license mortgage lenders and mortgage brokers. To date, 40 State mortgage regulators have committed to coming onto the system.

Chairman Frank, Representatives Watt and Miller, CSBS appreciates that your bill, H.R. 3915, incorporates our system as part of the regulatory infrastructure. I would also like to thank Representatives Bachus and Pryce for their support that H.R. 3012 gives the State licensing system.

This State system is more than a database. It is the foundation for coordinated multi-State mortgage supervision. Included in my testimony is some suggestions for refining H.R. 3915 to maximize the effectiveness of the system.

Second, Chairman Frank, we endorse your bill's establishment of consistent standards to address responsible lending.

Third, CSBS strongly supports the approach of establishing these standards as a floor, as opposed to a ceiling. States must retain the flexibility to address emerging issues. This allows States to establish best practices, which may become the foundation for Federal legislation.

For example, the Truth in Lending Act was originally implemented by my home State of Massachusetts in 1966, and the first predatory lending law was originally enacted by North Carolina in 1999.

Fourth, States must have clear authority to take enforcement actions against violation of these standards for the benefits of consumers in our States.

The residential mortgage market is now global in its scope, but the consequences of lending abuses will always be local. Given our proximity to the communities we serve, State regulators and law enforcement agencies are uniquely posed to respond quickly to the needs of our consumers and our homeowners.

Fifth, CSBS commends Congress for facilitating State and Federal coordination by giving State authorities a vote on the FFIEC. Since the States joined the FFIEC, cooperation between the Federal banking agencies and State authorities has improved dramatically. However, we encourage Congress to make sure that States are included in any new Federal rulemaking processes for mortgage providers.

The FFIEC provides the most appropriate forum for developing these new rules. We suggest that this mechanism best leverages State experience in developing the rules required to implement your legislation.

Finally, I would only add that I believe I am the only person at the table who actually regulates banks, credit unions, mortgage lenders, and mortgage brokers, and I do love all of my children.

[Laughter]

Mr. ANTONAKES. There has been a great deal of discussion today by the members that no single party or groups of parties are responsible for the issues we face today, and I do agree with that position.

We do support stronger safeguards for loan originators and we believe that your bill will effectively carry that through. However, it is important also to note that it was underestimating and misstating of credit risks and the failure of internal controls by depository institutions and non-depository institutions that significantly contributed to the problem we face today.

Thank you for the opportunity to testify. I would be happy to take any questions you may have.

[The prepared statement of Commissioner Antonakes can be found on page 128 of the appendix.]

The CHAIRMAN. Thank you. The committee will be in recess. We have only two votes, about 8 minutes left on this one, and then a quick 5-minute vote. We should be able to be back in less than 20 minutes, and we will immediately begin the questioning.

[Recess]

The CHAIRMAN. The hearing will reconvene. We will begin the questioning with my two co-authors here, along with the gentleman from New York. We will begin with the gentleman from North Carolina, who is one of the major authors of this bill, Mr. Watt, who is recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman. Let me thank the witnesses for being here and particularly thank the FDIC representative and the Comptroller of the Currency, and Mr. Antonakes.

Measured against the standard that I set in my opening statement, which was taking this from a philosophical discussion to a practical discussion of the bill that is in front of us, I would have to say I was not overwhelmed by the testimony of the other witnesses on that criteria.

I am hopeful that if you have not already done so, maybe you have in your written testimony because I confess, I did not get a chance to read it all, if you have not already done so, I hope you will take a very aggressive look at the bill that is now before us because Mr. Reich, Ms. Johnson, and Governor Kroszner, your testimony could have been delivered and was delivered several weeks ago outside the context of a bill.

We now have a bill in front of us that we really aggressively need your feedback on. If you are not going to play that role, then I am not sure that it is going to be that helpful to us.

I appreciate the platitudes and the bragging about what your agency has done or what you have done, but at this point, we are looking for feedback on a bill that is in front of us.

It would be helpful to get some feedback on the bill. That having been said, Mr. Reich suggested, although there is nothing about it in this bill, some things that we ought to, I guess, be considering putting in the bill, one of which was to allow a longer pay out to brokers. You suggested that, did you not, Mr. Reich?

Mr. REICH. I did.

Mr. WATT. The question I wanted to ask was whether under the mechanism that we have set up that allows rulemaking to occur, that would not be able to be accommodated or would it or would it not be able to be accommodated under the authority that we gave the regulators to write rules for the road going forward in this area?

Mr. REICH. It could be that the Fed may have that authority under their rulemaking authority.

Mr. WATT. My question is on the language in this bill that allows more than the Fed to be involved in rulemaking. Have you read the bill?

Mr. REICH. Sir, I have not read the 66 pages in the bill.

Mr. WATT. No wonder we did not get any comments on the bill. Did you understand the hearing today was about the bill?

Mr. REICH. Absolutely. I have read a summary of the bill and was informed that we could submit a more detailed—we just received it 2 days ago—that we could submit a more detailed statement by Friday of this week, which OTS intends to do.

Mr. WATT. I will not ask any more questions about the bill. There is a provision in there that allows rulemaking to occur. It seems to me that if we need to make it clearer that rulemaking authority extends to the ability to have a longer pay out for brokers, we could make that explicit very easily.

I am not sure—I do not believe that authority is already in the bill. I guess there is no sense in us debating it if you have not read the provision.

My time has expired. I appreciate the constructive comments that were made by some of the regulators. I encourage the other regulators to please read the bill and give us some feedback. Do not just wait until we do something or do not do something and then say well, you know, this is my public invitation to you all to play a constructive role in this process.

I think the Chair has already pointed out that we would like to get this done some time and move the bill. The quicker you all could get back to us, the more I would appreciate it.

I thank the chairman and yield back.

The CHAIRMAN. I thank the gentleman. I would reinforce that. I should acknowledge that we did want to make a commitment to having the broadest possible consultations on the bill, which meant that we did not introduce it—it is a shorter than usual interval between the introduction and the hearing, but that is why we agreed that the record will be open for the rest of the week.

The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman. Mr. Dugan, I am going to ask you and Mr. Reich, you all have said you do not think your member institutions ought to come under the national registration and licensing provisions.

Have you read my bill dealing with national registration and licensing?

Mr. DUGAN. I confess I have not.

Mr. BACHUS. Have you, Mr. Reich?

Mr. REICH. I have not.

The CHAIRMAN. His was introduced earlier.

[Laughter]

The CHAIRMAN. My apology does not cover his bill.

Mr. BACHUS. In fact, I read two articles, one in a New York publication, a Today Business publication, which obviously had not read it either when they talked about the different proposals.

I separate out registrations and licensing. What we require of everyone is that they register. Let me tell you why I did that. When you look at the mortgage originators that originated some of these fraudulent loans, some of these loans where mis-information was supplied, some of them were from your member institutions. They were not all mortgage brokers.

In fact, my staff and I—I do not have this statistically, but one time, we have used the figure of about 40 percent of them were from either federally or State chartered institutions that were regulated. Sixty percent of them were mortgage brokers.

If you only require mortgage brokers to register, which is basically what is being said, but you do not require mortgage bankers, there is obviously a gap in the system today. We would not be proposing that if we didn't have—whether it is 25 percent, 30 percent or 35 percent—you are dealing with hundreds of thousands of these that have been made by originators that were working in a bank. I do not know of any in a credit union, but I am sure there may be.

With that in mind, let me tell you what I require of your members. The licensing requirements in my bill, because you have different requirements to set up, but the registration requirements are that they provide contact information.

The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, they maintain databases on bad actors. If you do not register, if you are not included, your people making loans in your banks are not included in that registration, and we have no way of knowing they are there.

Mr. DUGAN. Mr. Bachus, let me be clear. We do agree and think there are good provisions in the bill that require banks to report bad actors to a database and we also agree—

Mr. BACHUS. We are talking about registration. Some on both sides have endorsed it. I know the chairman is looking at it. It requires them to keep contact information. We want to know where they are. That is disclosure.

We want them to submit to a criminal background check and submit fingerprints. That is what a lot of the States require now. An applicant has to submit to a credit check, which sometimes exposes losses as a result of fraudulent practices. That is all it requires them to do. It is very effective when it is used.

If we have a turf fight—the FDIC, we have approached them and they have not, at least from our correspondence, and the Federal Reserve, in fact, Chairman Bernanke and Secretary Paulson both said there is a need for some sort of national registration or database.

I would just like you going forward to take a look at that.

Mr. DUGAN. We certainly will.

Mr. BACHUS. Do not confuse the licensing provisions. You have your own. You have your own provisions. You require certain educational standards. The State and federally chartered institutions are exempt from that for a good reason, but not the registration. We would have an incomplete registration.

If we are going to fully protect—we cannot ever fully protect, but if we are going to at least try to know who these people are and where they are, because they move from State to State, in fact, 5 percent of mortgage originators did 95 percent of what I would call the over-the-top bad loans. Most of them, their license had been revoked in one State and they moved to another State.

Mr. DUGAN. We would be delighted to have a greater dialogue on that point. You are absolutely right. We have been sort of conflating licensing and registration. It is the licensing part that puts more substantive regulatory and compliance requirements that would have to be put in place that I think raises the bigger questions.

Mr. BACHUS. If you do not know the history before they come or if they do something while they are originating loans at your institutions, then they leave, and they are not a part of it.

Mr. DUGAN. We support that part of it.

Mr. BACHUS. Thank you. The only other question I would ask is I would ask the Federal Reserve, I noticed that in the rulemaking process under this legislation, they are excluded. They have decades of constructive experience in developing legislation.

I was just wondering, do you have any comment on that, Governor?

Mr. KROSZNER. Thank you very much. If you were to include us, exactly as you had said, we would bring years of experience, years of expertise, and knowledge to consumer protection and community affairs' issues. I think we would have something valuable to add to the rule writing process.

Mr. BACHUS. Thank you.

The CHAIRMAN. We will go to the gentleman from Pennsylvania, the chairman of the Capital Markets Subcommittee.

Mr. KANJORSKI. Thank you, Mr. Chairman. Chairman Johnson, you mentioned the escrow and appraisal bill that I have introduced in your opening remarks. I am pleased to see that you are favorably disposed to it. Also, I noticed the Federal Reserve through rulemaking is considering doing something in the escrow area.

What I appreciate is the fact that Chairman Frank and I have agreed to mark up this legislation, H.R. 3837. If your agencies could, by next Monday, give us any of your comments on this bill, so that it either may be joined with the pending bill or stand individually. We think it has an opportunity to move, and it could go a long way in helping future problems in the system.

Also, I wanted to say to you, Chairman Johnson, that I agree with you, and I note that Chairman Frank stated that NCUA was not on the list of agencies involved in writing the rules in H.R. 3915. I assure you, this is an oversight and not intentional, and we are going to correct that as the bill moves forward.

Actually, what we would like to do is have everybody participate as much as possible in helping us move this through.

The CHAIRMAN. If the gentleman would yield, the gentleman has been very much involved in credit union issues, and he is absolutely right, that is an omission that we will deal with.

Mr. KANJORSKI. One of the issues I am involved in is assigning liability. We are going to be talking a lot about this, particularly as we consider this bill.

If we really go too far, we are going to dry up the secondary market. If we do not go far enough, we are not going to really gain any positive ground here.

I think we are somewhat at a loss to know what to do. Again, I think we should create a standard, if possible, whereby the writers or the assemblers of these packages should be responsible for what they can know, should know, or reasonably discern.

On the other hand, we should have a clear bright line standard to help assignees know what they need to do to meet these tests.

Do you have any particular views on the assignee liability question? Any of you? If you do, over the next several days, I think you can submit it, and it would be very, very helpful.

To the last gentleman, let me bring up the need for a national standard. We are struggling with it. Of course, this bill does not provide a clear national standard. I think it should.

Rather than have a knock-down, drag-out fight because we cannot ever seem to come together as to what that standard would be, what I was going to suggest today is that we think about how we solved this problem back in 1996 on fair credit reporting. We actually committed and created a national standard, but we gave it a life expectancy of 7 years, with the idea that we would have to come back and have the Congress address it and correct it or remove it, or do what was necessary to make it more applicable to the problem.

Do you think this provision, if acted upon by Congress in this instance, in creating a national standard but with a time frame and a sunset provision, would be a way that we could move to find middle ground and make the system work better to have a national standard?

I throw it out at any of the regulators who want to take a shot at it. Yes?

Mr. REICH. I am totally supportive of the notion of sunsetting almost every act of Congress, quite frankly, for a review on down the road to determine its effectiveness.

Certainly in this instance, I would be supportive.

Mr. KANJORSKI. I tend to agree with you, I am always supporting sunsetting. I do not always get my way, but I like to support it, too.

Do you think if we take this legislation and put a national standard into place, is this the time to do it or just leave the legislation as it presently is, taking into consideration every State has different conditions?

Mr. REICH. My personal view is that I would like to see a national standard with a bar high enough that it would satisfy all of the States. I recognize that goal is probably not achievable. I think working towards a national standard is the right thing to do.

Mr. KANJORSKI. What if we took, say, the North Carolina standard and adopted that nationally, but put in the 7-year provision that it has to be re-visited and reviewed, would that be a way?

It is going to require an intelligent compromise. We are just not all going to agree up here. The House and Senate are not going to agree. The Administration is not going to agree. Certainly, the industry is not going to agree. We have seen that happen for a number of years now.

How do we get past this stumbling block, when we do come very close now because of exiguities in the marketplace, that we can move something that otherwise could not be moved as well or as quickly and as speedily?

Should we take a shot at it now or should we pass it by?

Mr. REICH. I wish I knew the answer to that question.

Mr. KANJORSKI. Cautious.

Mr. GRUENBERG. If I may say, Congressman, I think the approach taken in the bill as introduced of setting a floor so that we establish a national minimum to assure uniformity but then allowing States in their discretion to go beyond that is a reasonable approach.

Mr. ANTONAKES. Congressman, I would agree. Our preference would be to have the floor as high as possible but we would also like to have the States have the right to address specific issues quickly if they want to go beyond that floor.

Mr. KANJORSKI. You do not see that is going to have an effect on securitizing these obligations? If we have States that have huge standards as compared to other States, it is not going to have an effect on putting these packages together?

Mr. ANTONAKES. In my view, at least in Massachusetts, where we have a very high standard, it has not impacted the availability of credit in the Commonwealth. If laws are crafted carefully, we believe there can be higher consumer protections without impacting the availability of credit.

Mr. KANJORSKI. Thank you very much.

The CHAIRMAN. Thank you. What duration would you like on the sunset legislation for the Office of Thrift Supervision?

Tell me how many years, and we will be glad to file the bill to accommodate that.

Mr. DUGAN. Five.

[Laughter]

The CHAIRMAN. When Secretary Paulson proposes his reorganization of the bank regulatory agencies next year, that might get some action.

The gentlewoman from Illinois, the chair—the Ranking Member of the Capital Markets Subcommittee.

Mrs. BIGGERT. Don't I wish I was chairman!

[Laughter]

Mrs. BIGGERT. Thank you, Mr. Chairman. This is a question generally, for whomever would like to answer.

By restricting which borrower is eligible for loans, do you think that H.R. 3915 in its current form will limit access to credit to individuals with less than perfect credit, and as a result, homeownership would more likely be limited to individuals in higher income groups, and can the legislation or should it be altered to avoid what I think might be this unintended consequence?

Mr. DUGAN. As I testified, I think the purpose of the legislation and particularly the safe harbors, which we believe is kind of what lenders and originators will gravitate to because it will prevent people from being exposed to liability, its purpose is to restrict the supply of credit in the sense of not providing it to people who cannot afford to pay the loan.

It is a tradeoff, as I said. I think it will restrict credit. You hope that it will only restrict credit so it will not go—let's call it bad credit—that would go to people that cannot afford it, but there is a risk that there will be creditworthy borrowers who could shoulder the loans that a willing lender would be willing to make that loan to who will be prevented from doing so by the very bright lines that we have in it.

I would note in a few places, those bright lines are brighter and stricter than what the Federal banking agencies agreed to do in our guidance. I think as I said, it is a tradeoff about whether you want to really be sure that people can repay and risk that fewer people will get credit and fewer people will be able to at least initially purchase a home.

Mrs. BIGGERT. Thank you. We have been talking about the subprime loans. Does anyone think that the prime loans helped to create the current housing finance problem? If not, is there any reason to think it was their regulation?

Mr. DUGAN. Most people believe that the current problems that we have started in subprime. Certainly right now, we have problems in market liquidity for other mortgages. The real problems that I think most people have focused most dramatically on happened in the subprime area.

Mrs. BIGGERT. There should not be any changes in the regulation for the traditional prime loan?

Mr. REICH. I do not believe there should be.

Mr. GRUENBERG. I think, Congresswoman, the general approach to this bill in effect is to carve out the prime mortgages and focus the attention of the protections on the higher cost segment of the market, which really has been the focus of the issues.

Mr. DUGAN. If I may, that is true for part of the bill, but there are other parts of the bill that have standards that apply across the board, the Federal duty of care, the anti-steering provisions, and the like. To that extent, they do go beyond the subprime market to the prime market as well.

Mrs. BIGGERT. You think those are good?

Mr. DUGAN. I think there is a question about them. As I testified, some of the provisions have quite subjective language in it that we fear will be difficult to implement, and I think more pronounced problems that we are responding to, as your question suggests, have been in the subprime area, and I guess our guidance has been more focused on that area, and I think that makes sense.

Mrs. BIGGERT. Vice Chairman Gruenberg, the FDIC has been such a good supporter of financial literacy, and I appreciate it, and Chairman Johnson, too, and all of you for all that you have done to promote the financial literacy and financial education.

Do you think legislation that seeks to combat fraud in the mortgage practices should also—would you support counseling for borrowers?

Mr. GRUENBERG. I think counseling is a valuable adjunct to the protections and can be certainly helpful to borrowers in trying to deal with the complex mortgage products; yes.

Ms. JOHNSON. I would agree. The focus on financial education up front, whether through the counseling, for all borrowers to better have more clear and concise disclosures and transparency, will aid everyone in the market that is securing a loan.

Mrs. BIGGERT. It is just the problem has been whether mandatory or not, and if mandatory, like what happened in Chicago, people not being able to get the counseling in time and they lost the mortgage.

Do you think it should be mandatory or just notice of the ability to get counseling?

Ms. JOHNSON. I think to continue awareness of this issue, and I know through the credit unions that we work with we have made financial education a priority, and so it has actually been they have taken up the charge without it being mandated by a regulator or through a law.

I think the opportunity is there and hopefully more people will grab onto it.

Mrs. BIGGERT. Thank you. My time has expired.

The CHAIRMAN. I will take my questions and then we will break for the vote. I do want to say to Governor Kroszner, the question about the Fed's ability to produce some regulation, frankly, from my experience, the Fed has a lot of unused regulations stored up. They should be able to dip into a pile of unused regulations and maybe come forward.

The gentleman from Pennsylvania is correct in terms of the omission of the NCUA. That is clearly something we should deal with.

Let me ask, Commissioner Antonakes is representing not just Massachusetts but the State Bank Supervisors. There are several major elements in this bill. One, I think, is generally agreed on, that all mortgage originators should be subjected to rules, and that the problem has been exactly what the nature of the rules are, but we do want all mortgage originators subjected to rules.

Then there is the question of securitizing liability and how we would do that, if and how we do it. Then there is the question of the substance of the rules that are applied.

I was pleased, Commissioner Antonakes, that you say on page 10, "A Federal anti-predatory lending standard should say clearly and ambiguously that lenders must consider a borrower's ability to repay a loan and include all costs of homeownership," and you want this to be a Federal floor but not a ceiling. Is that correct?

Mr. ANTONAKES. Yes.

The CHAIRMAN. You speak for the Conference of State Bank Supervisors, and this is one of the more controversial aspects of the bill.

Mr. ANTONAKES. Yes, that is correct.

The CHAIRMAN. I thought it would be relevant, Commissioner. I appreciate your support for the thrust of this degree of regulation. When were you appointed Commissioner?

Mr. ANTONAKES. December 2003.

The CHAIRMAN. And you were appointed by whom?

Mr. ANTONAKES. Governor Mitt Romney.

The CHAIRMAN. Governor Romney. Thank you.

The question I then have for all the regulators, and I understand—this is particularly for the bank regulators but also for Commissioner Antonakes, we were of the opinion that the regulated entities, credit unions and banks, were clearly less of a problem because of the regulation.

What we were trying to do in some ways was to take the regulations you have applied to the institutions under your jurisdiction, codify them statutorily, and apply them to others.

I take it some think we may not have done that well enough. We would certainly welcome help in doing that. We have this too much ambiguity and too much rigidity.

Let me ask the bank regulators, in terms of the effort we have made to articulate the standard, should it be tighter, looser?

Let me start with Mr. Gruenberg and go down.

Mr. GRUENBERG. Mr. Chairman, I think as a general matter, the standard that you have outlined in the bill has been, as you indicated, reflective of the standard generally applied by Federal bank regulators. It seemed to us a reasonable approach.

The CHAIRMAN. Yes. Mr. Dugan?

Mr. DUGAN. We did try to point out some areas in the testimony where the particular standard—the standard I am talking about now is the safe harbor standard. I think that is the place that most lenders and originators will gravitate to because of the absence of liability.

There are a number of places in those standards that are stricter than what we put in place in the Federal banking agencies' standards. For example, the 50 percent debt to income ratio, the prohibition on negative amortization.

The CHAIRMAN. We do not want to leave it totally subjective.

Mr. DUGAN. I understand that. You have to have sharp lines in order to have a safe harbor. We get that. We would be happy to provide more specific comments for the record.

The CHAIRMAN. I appreciate that. Mr. Reich?

Mr. REICH. I, too, intend to provide a more detailed written response.

The CHAIRMAN. I appreciate that.

Mr. REICH. By the end of this week. I share some of the same concerns that Comptroller Dugan just mentioned with the specificity—

The CHAIRMAN. Let me ask you this. We are at an experimental stage here. Mr. Dugan reminded me, there are two aspects really of this standard. One is the standard that is applied in the States to the extent that the States are—by the way, I have to say with regard to national uniformity, I assume nobody thinks—there will still be State banks and the FDIC will be regulating them, but we are not taking away the autonomy the States now have. I assume no one is asking us to do that.

It seems to me the standard of care has two aspects. One is what the States' jurisdiction allows them to impose and then there is also the extent to which that governs the safe harbor.

Is that intellectually a separable set of concepts? Is it conceivable that you would have one rule for the safe harbor and then the States would be able from the standpoint of securitization—I understand the argument for uniformity in securitization rules nationally.

If you were to deal with that as a safe harbor, what is then the argument for diminishing State autonomy in their general administrative capacity other than the safe harbor? Is that something that makes any logical sense to think about?

Mr. Dugan?

Mr. DUGAN. I am not sure I am following the question. The question is if you had an uniform standard for just the S&E liability provision but did not have it—

The CHAIRMAN. But the States could then, if they were administering this rule with the people they regulated, whether mortgage brokers or State banks, they could impose greater standards if they wanted to.

Mr. DUGAN. First of all, a huge part of the market gets securitized. It is not now but before August, it was about 75 percent of the market that was not Fannie Mae and Freddie Mac that got securitized, something in those numbers. You are talking about a huge part of it.

Secondly, I think people would gravitate to the safe harbors just because they would want to avoid the Federal liability, and then if the States wanted to go beyond that, I do think it would still create issues about uncertainty for people who lend across State lines and do it in different States. You are going to have those issues.

The CHAIRMAN. If you want to go across State lines. They have it now, do they not? People want to lend across State lines, are there not those differences?

Mr. DUGAN. For some lenders.

The CHAIRMAN. Mr. Reich?

Mr. REICH. I agree with Comptroller Dugan. I do have the fear that the safe harbor will result in drying up of liquidity.

The CHAIRMAN. That is not the question. I was talking about whether you could separate out the standard, whether the preemption—whether you need one standard for safe harbor but could give the States some autonomy elsewhere.

Mr. REICH. I said at the outset that I would hope it would be possible to have a bar high enough.

The CHAIRMAN. Let me say this. I appreciate your answers. I think we ought to be clear. The argument for extinguishing the States' ability to go above the floor is not rooted in the safe harbor concern but it is a general concern that says you do not like the States going off on their own.

I think you could separate out the safe harbor aspect from the broader aspect. I think that is this broader philosophical question we are dealing with.

It would seem to me if we were to do that, we would be not preserving the status quo here but diminishing some of the autonomy the States now have. I would be very reluctant to see that happen.

We are going to break now; we have some votes. We will come back. I apologize again, but that is the world we live in.

[Recess]

The CHAIRMAN. I believe I was the last questioner, so I will now call on the gentlewoman from West Virginia.

Ms. CAPITO. Thank you, Mr. Chairman.

I have a question on the lowering of the HOEPA triggers concerning whether that would exclude, if you all feel that that would exclude some credit-worthy subprime borrowers who would otherwise be able to receive loans and how can we guard against this unwanted consequence if in fact you believe that could be a consequence? Do you have an opinion on that?

Mr. DUGAN. To be honest, we haven't really done any empirical look at what loans would then fall under the lower triggers. I do think it is fair to say that in the past, HOEPA loans were viewed as so extreme that few institutions provided HOEPA loans once the definitions—because it was such a rigorous and what's the word, a scarlet letter of sorts that people wouldn't make the loans. So when you look at our home loan registry, for example, you don't find many HOEPA loans anymore.

That is not to say that there aren't rate-spread loans and costly loans and 2/28s and the like. By lowering the triggers, you are going to have more loans fall into that category. If that is the same effect, it will I think have a chilling effect on those loans that fall into that category. How deep that goes into the market, we just haven't yet to do the analysis on it.

Ms. CAPITO. Another question I have, I mean in front of me right now we have the FDIC, the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, the Federal Reserve, and then our State, Massachusetts State Division. Mostly my question is directed to the Federal regulators.

It seems to me that—would this bill be like defusing regulation between all of your separate entities? And then what kind of mechanisms do you have in place to cross-reference with one another as to what's going on?

It seems to me that if I was a citizen watching this hearing, and I hope we have a few watching, I would think to myself, "We're going to have too many hands in the pie here. Who is really going to be overseeing this as a Federal regulator? And what kind of influence is that going to have? Are they going to be talking to one another?"

Mr. REICH. Well, we have that environment today. Regulation is highly defused and the Federal regulators work together through the FIAC to establish conformity and consistency and policy and policy administration. So this would be another layer of regulation on top of that which we deal with every day.

Ms. CAPITO. So you don't anticipate that this would be a problem? It is something you already have the mechanisms in place for?

Mr. DUGAN. I know it seems like there are a lot of regulators at the table, but that is in fact, as Director Reich was suggesting, the normal way for all our regulatory schemes, they often involve joint work, rulemaking that's separately. And then we separately, once the rules come out, apply it to the institutions within our respective jurisdictions. I don't think this is much different in that respect.

Ms. CAPITO. All right. I have one final question on the—we have heard a lot about the floor and the ceiling and the modeling after the North Carolina Banking Administration in terms of the new legislation. I read some data that said that when these new regulations were put into North Carolina it resulted in fewer loans going to those low income and minority homeowners. I think it was maybe 3 or 4 percent, but it was a significant percent. Do you envision that this type of regulation could actually result in the folks we really want to help the most or we want to protect the most not being able to have a share of this market?

Mr. GRUENBERG. Congresswoman, candidly, I don't think that would be the case. I think the issue here that's well understood is the importance of extending credit to people who can afford to repay. That really is the key issue. And what you want is a set of standards to assure that outcome.

And the difficulty really occurs when you extend credit to someone and that person cannot pay the loan. So, you know, the experience here is a lot of people got loans who in effect could not afford to pay them. And that is really the issue we are dealing with today.

And at the end of the day you are not doing anyone a favor—in fact, you create a significant problem by doing that. So I think what you really want to shoot for is a set of standards that will give you some assurance that people are getting themselves into situations that they can afford and can sustain in the long term.

Ms. CAPITO. Thank you. That's a good answer.

I yield back.

The CHAIRMAN. Thank you. The gentlewoman from California.

Ms. WATERS. Thank you very much. Mr. Chairman, I have a few questions that I would like to ask of some of the presenters who are here today, particularly the regulators. First, do you agree with that portion of the bill that bans yield-spread premiums? To our regulators, first, Mr. Gruenberg, FDIC.

Mr. GRUENBERG. Yes, Congresswoman, we do agree that is a good provision.

Ms. WATERS. Mr. Dugan?

Mr. DUGAN. As I said in my testimony, it is quite a broad provision because it is not directed specifically at yield-spread premiums, it is at anything that involves any kind of differential in compensation and we do point out that that could apply to some things that are not based on profit margins, but have some beneficial effects.

Ms. WATERS. How would you change it?

Mr. DUGAN. Well, I think that it could be narrowed in some ways. That we would like to give some thought to and provide some further comments.

Ms. WATERS. But you don't have any problems with the concept of reducing the ability for originators to earn money based on steering people to higher loans than they can afford?

Mr. DUGAN. I think the biggest abuses of that authority has been in the subprime market. This is not limited to subprime. It applies across the board.

Ms. WATERS. So you think it should be limited to subprime?

Mr. DUGAN. Maybe. I think that is worth considering.

Ms. WATERS. Okay. Office of Thrift Supervision, Mr. John Reich?

Mr. REICH. I would not disagree with limiting it to subprime. I indicated in my testimony that in order to make certain that those who have an interest in the origination process have skin in the game so to speak. That any income that they receive from a mortgage origination ought to be spread out over a longer period of time and suggested using life insurance premium income to a life insurance salesman as a possible model.

Ms. WATERS. Mr. Antonakes?

Mr. ANTONAKES. I think really one of the biggest problems that we incurred is the number of people who would have qualified for prime lending but were steered towards subprime products. So I think anything that can be done to moderate compensation so that incentives aren't provided to push people into weaker products should be considered.

Ms. WATERS. Okay. Quickly. Do all of you agree that we should take a real hard look at no-doc loans? Or should they just be outlawed altogether?

Mr. DUGAN. What we did at the Federal Banking Agency Standard to say the presumption is that you shouldn't have them, but there are some cases in which it may be—

Ms. WATERS. Basically you shouldn't have them.

Mr. Gruenberg?

Mr. GRUENBERG. I would generally agree with that, Congresswoman.

Ms. WATERS. Office of Thrift Supervision, Mr. Reich?

Mr. REICH. There are institutions, Congresswoman, that have been making these types of loans for 20 years or longer and have a successful record.

Ms. WATERS. So you think they should continue no-doc loans?

Mr. REICH. I personally do not favor either, no-doc loans or stated income loans.

Ms. WATERS. Okay. Board of Governors, Federal Reserve, Mr. Kroszner.

Mr. KROSZNER. As you know, we are looking at exactly this issue with respect to our HOEPA regulations and we are taking a very hard look at where, if at all, they would be appropriate.

Ms. WATERS. All right. Let's go to the elimination of prepayment penalties. Mr. Gruenberg, do you think we should eliminate all prepayment penalties?

Mr. GRUENBERG. Certainly in the subprime—

Ms. WATERS. I cannot hear you.

Mr. GRUENBERG. Certainly for subprime mortgages, which is where they predominate, there seems to be no reason to have prepayment penalties.

Ms. WATERS. Mr. Dugan?

Mr. DUGAN. As we did in our guidance, I think the focus should be you should never have prepayment penalties that extend beyond the reset date of an unadjustible rate loan.

Ms. WATERS. Mr. Reich?

The CHAIRMAN. Could I clarify that? Would the gentlewoman yield?

Beyond, you mean before the reset?

Mr. DUGAN. Before. Excuse me.

The CHAIRMAN. Before the reset.

Mr. DUGAN. The penalty shouldn't go beyond, right.

The CHAIRMAN. You should not have a prepenalty that would lock you into it beyond reset. Thank you.

Mr. REICH. I agree with that. I also believe that prepayment penalties result in a lower interest rate for the borrower.

Ms. WATERS. Ms. Johnson?

Ms. JOHNSON. Federal statute prevents credit unions from charging prepayment penalties already.

Ms. WATERS. Do you think others should have prepayment penalties?

Ms. JOHNSON. Well, I'd leave that judgement to the members, but it works for credit unions.

Ms. WATERS. Mr. Antonakes?

Mr. ANTONAKES. I think they should be very limited if not outlawed.

Ms. WATERS. Do you agree that the standards that are being set with this bill would take a look at the teaser rates and whether or not you are judging to pay based on the terms that the teaser rates or the ability to pay beyond the teaser rates when the new rates are triggered?

Mr. GRUENBERG. I believe the basic purpose of the bill is to require underwriting to the fully indexed rate and to the borrower's ability to pay.

Ms. WATERS. Does everyone agree with that?

Mr. DUGAN. Yes.

Mr. REICH. Yes.

Ms. WATERS. Okay. I think my time is up. Thank you very much, Mr. Chairman.

The CHAIRMAN. You could end on a roll.

The gentleman from New York, the chairwoman of the Financial Institutions Subcommittee.

Mrs. MALONEY. Thank you, Mr. Chairman.

I would like to ask the Vice Chairman of the FDIC, Mr. Gruenberg, to follow up on statement that Sheila Bair made recently when she advocated for servicers to restructure adjustable rate mortgages, the so-called 2/28s and 3/27s, into a fixed rate mortgage at the initial rate saying that only about 1 percent of these mortgages have been modified. And how would this work given the complicated process of securitization?

Mr. GRUENBERG. I'll take a crack at that although I think it would be best obviously to ask Chairman Bair. I don't think there is any more urgent issue confronting us in this subprime mortgage area than dealing with the subprime mortgages that are in the process of resetting and that are going to reset the rest of this year and next year.

You have hundreds of thousands of people who really are going to be placed at risk of losing their homes. And this whole issue is complicated by the fact that, as you know, most of these subprime mortgages are tied up in securitizations which significantly complicate the ability to restructure them so that the borrower can afford to pay them on a long term basis.

I think what Chairman Bair has proposed is a workable way for servicers, since most of these mortgages are in securitizations, it is the servicer that is really trying to work out these mortgages rather than the lender or the originator.

What has been proposed is that the servicers simply modify these loans to fix their rate for the term of the mortgage at the starter rate. The point being that for subprime borrowers who have been making their payments at the starter rate, the fact is that in many cases, the starter rate is actually higher than the prime rate. And for these borrowers to allow them to continue to make the payments, to stay in their homes and for the investors to avoid the cost of foreclosure is really a far more preferable outcome and a very workable one. That is really the heart of what has been proposed.

Mrs. MALONEY. She has proposed it, but people are not following through. Only 1 percent have responded. This Congress has modernized FHA. It has had FASB change modification and restructuring rules for the servicers and it is not happening.

She likewise called for mass restructuring and what did she mean there? And how can we get this 1 percent up? Because that is really the crux of it. Everybody says they want to help, but it is just not happening.

Mr. GRUENBERG. I think that is the critical issue. I think this proposal is a workable way for servicers to address this issue. There are some servicers that I think are moving forward with constructive programs. I think the challenge here is really to get the servicers as a group, to adopt a set of common approaches that will be effective in modifying these mortgages so that the homeowners can stay in them for the long term.

Mrs. MALONEY. And following up on that, what do you recommend current standards include to prevent this sort of widespread problem in the future?

Mr. GRUENBERG. I think the standards going forward—as you know, the regulators have issued a set of guidelines relating to subprime mortgages, fundamentally requiring underwriting to the fully indexed rate and other protections.

Mrs. MALONEY. Do you wish to add anything to that recommendation?

Mr. GRUENBERG. I think there are a series of recommendations and we have additional protections and most of them are embraced in the legislation that has been introduced. I think that would be a reasonable way to proceed going forward.

Mrs. MALONEY. John Dugan. Lehman Brothers and others have predicted that the next few years, in the next few years literally millions of families will lose their homes. Some predict that more people will lose their home than they did during the Great Depression.

What role, if any, do you think the OCC can play to keep as many homeowners as possible in their homes?

Mr. DUGAN. Well, first of all, we have already issued guidance to our lenders who have made these loans, who are the servicers of the loans to work with their borrowers to try to find ways to avoid foreclosure because the fact of the matter is when you foreclose on a home, just purely from an economic point of view on the point of the investor, you lose a tremendous amount of value.

Mrs. MALONEY. We are all aware of that, but the action is just recommending to borrowers—

Mr. DUGAN. And the alternative of restructuring in ways so that we may have to take some loss but not as much loss as you would take if you would foreclose should be in the economic interest of people to do that.

And I think encouraging servicers who service those loans or lenders who own those loans to be creative, to go out and to do the kinds of things you were just referring to earlier, I think those are constructive ways to proceed.

Mrs. MALONEY. Thank you, my time is up.

The CHAIRMAN. The gentleman from New York. The gentleman from North Carolina began this round of questioning. It was so long ago people may have forgotten. It is the gentleman from New York's turn now.

Mr. MEEKS. Thank you, Mr. Chairman.

Let me ask, I guess Mr. Kroszner, or anyone else on the panel. In my opening statement I talked about this practice known as equity stripping where individuals promised to help homeowners avoid foreclosure by buying their home and selling it back to them.

Instead, they strip out all the equity making it nearly impossible for the former owners to buy their home back. My question to you is are you aware of this practice and from what you have seen thus far of H.R. 3915, do you think that it can address it?

Mr. DUGAN. If I could begin? We are aware of it. We have published guidelines that address it specifically and direct our banks not to engage in that activity.

Mr. MEEKS. Let me ask this also. If H.R.—

Mr. KROSZNER. I agree.

Mr. MEEKS. I saw everybody shaking their heads saying they agree. Any disagrees?

If H.R. 3915 was a ceiling, if it was a ceiling and I guess I will ask Mr. Dugan this, first, would you have any objection to local enforcement by State AGs or the banking regulators?

Mr. DUGAN. Well, I think this is a very good question, because as I mentioned in my testimony, you have a situation where while you have a nominal consumer litigation, civil litigation that applies to everybody, in the case of banks, you also have the agencies at this table there that would have the ability to impose quite stiff penalties and fines in how they do what they are going to do. But for the unregulated sector—not regulated, Non-federally regulated sector that are not banks at the State level, there is a much lower level of enforcement that would be provided to them. And the bill does not really speak to that.

What you are talking about would be a suggestion that would add additional enforcement authority with respect to that. And that would partly level the playing field and provide a more even kind of enforcement regime.

Mr. MEEKS. Mr. Steven Antonakes, what do you say?

Mr. ANTONAKES. Well, I would beg to differ with my colleague with regard to the lack of enforcement actions. With 3,600 actions taken last year by the States, alone, and probably more than that taken this year, you know, is there room for improvement and raising the bar in some States? Absolutely. We are working hard to do that.

But, again, a ceiling I think is difficult because then you preempt States from the ability to react to local issues and go beyond that ceiling and the ceiling becomes static and, you know, who knows what the mortgage market is going to look like 5 or 10 years down the road. So I think a floor is better. I think State and local enforcement AGs is very important.

You know, there have been some landmark cases, very large settlements that came from the States. I do not need to name them. They are all well known. And I think that is something that we will continue to work on.

Mr. MEEKS. Mr. Gruenberg, let me ask you a question on a slightly different topic, something I read this morning. I think Merrill Lynch reported a write-down of at least $5 billion. Some outside analysts predicted it would be $7 billion for the third quarter of this year due to losses in the subprime investments.

I just want to make sure, if I am understanding it correctly, Merrill is an investment bank that does sweeps of customer funds into depository accounts which affects the ratio of insured deposits. I think that is correct.

So my question is, will these substantial losses by Merrill have any effect on the Insurance Fund?

Mr. GRUENBERG. I suppose, Congressman, you directed that question to me. You know, I think we would have to take a look at that. I would want to be cautious about responding to it until we actually looked at the facts of which you were reporting on in regard to the story this morning.

Mr. MEEKS. Well, if you can, I would love you to get back to me.

Mr. GRUENBERG. We will do that very promptly.

Mr. MEEKS. Thank you. I yield back.

The CHAIRMAN. The gentlewoman from New York is recognized.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman, and I appreciate the panel having patience with us and being here for such a long time. I want to go back to something that Mrs. Waters was talking about in the beginning, and I know we've already heard that some of you haven't had a chance to read the bill because it came out actually late Monday afternoon. So if you can't answer it, I don't mind, you know, if we get an answer back in written form, you know, down the road.

On Title I on page 12, lines 10 through 15, it talks about prohibition of steering incentives. And I guess my question would be, would any of you interpret the bill, specifically Title I, as prohibiting indirect compensation for originators? And, again, I don't mind waiting and getting an answer back, because this is the answer that we want from you as we go through the bill.

The second question, did any of you have an inkling that this was coming down the road? Because I'll be very honest with you, I mean, we on this committee have been talking about predatory lending, well, for the last couple of years. There has been legislation there. Some of the States—New York, Massachusetts—have been looking at how we could stop the predatory lending, especially in the minority areas and especially towards our senior citizens. I mean, you're watching, overwatching, supposedly, that. That's why we have this legislation in front of us.

So nobody had an inkling? And I think this is just the tip of the iceberg. I do believe we're in for a rough ride down the road. I'm even wondering if this legislation is coming a liability too late. With that, I'll ask—yes, ma'am?

Ms. JOHNSON. We actually at NCUA issued a supervisory letter to our examiners a little over 2 years ago, back in 2005, specifically addressing the exotic loans and subprime, the risk in some of the subprime area. We sent the same information then to our credit unions. So they knew what we were looking for and what we were, you know, what we would be examining. And so we feel that we did have a little bit of an early action in this area, and we think that's part of the reason that our numbers aren't quite so bad.

Mrs. MCCARTHY OF NEW YORK. I actually had heard that the credit unions were not having any problems with these issues, but, again, I come back, and even when you heard about it 2 years ago, and, again, you're all regulators, why didn't you come forward to at least this committee? Because we've been talking about it. And why didn't we hear from those—

Mr. DUGAN. Well, speaking for the OCC and for national banks, we did have some very significant problems in the credit card area with subprime lending, abusive subprime lending that we did take some quite aggressive action about it and infused the agency with that kind of concern.

I think it's fair to say that a relatively small percentage of subprime mortgage lending, and particularly the most aggressive of it, was done in national banks or their operating subsidiaries. As a result, we did not have as big a percentage of those markets. We had about 10 percent of originations last year. And of those, the rates of default have been well below the national average. So I think we do look hard at it. In addition, on predatory lending per se, we have always made it clear you can't do that in national banks. We've been quite rigorous about that standard.

Having said all of that, I don't think anybody anticipated that the problem could spread like it has from the subprime markets to the prime markets to the credit markets more generally. I think that was truly something that was not anticipated.

Mrs. MCCARTHY OF NEW YORK. Well, one of the things that concerned me, and I know Mrs. Biggert had started on it with the prime market, the majority of people, especially young borrowers, have been taking money in home equity loans basically to improve their house and taking a lot of money out, and they're going to get hit probably in the next couple of months with some—so, even though we're talking about subprime, there are going to be a lot of prime owners who are going to be hit with this. And I'm just wondering if we shouldn't be looking at that a little more closely, too.

Mr. DUGAN. Well, of course, we do examine for credit issues and compliance issues in all of our retail lending, including home equity lending. It's something we pay very careful attention to. As you may have seen, a number of the larger institutions have begun setting aside more reserves for losses with respect to home equity lending, which we believe is prudent, and that is an area which we will be continuing to focus on.

Mrs. MCCARTHY OF NEW YORK. Just one final question. Yesterday we met, the New York delegation met with the Commissioner of Banks for New York State, and they're doing a campaign, an advertising campaign, and they've been doing it for the last 6 weeks or so, I guess. And out of all the information that has been going out there, all the information our congressional office has been putting out there for the State, or the State of New York, only one person—only one person—has actually applied to have it refinanced in one way or the other.

How do you see it out in the other parts of the country about people responding to whatever the banks and other entities are getting that information out there to the consumer?

Mr. DUGAN. Well, I think it is a kind of very well-documented problem that on the one hand, studies show repeatedly that the sooner a borrower experiences difficulty, the sooner they contact their lender—

Mrs. MCCARTHY OF NEW YORK. Right.

Mr. DUGAN. —the much more likely that we'll be able to work it out. I think, unfortunately, there is a concern that sometimes a borrower thinks of the lender in that circumstance as not his or her friend, and so there is an issue about their willingness to do it. And try as lenders might, they haven't been getting the response rates they need.

That is, however, why NeighborWorks America, which a number of us sit on the board of, have embarked on a very strong national campaign with 800 numbers and the like, and have been using community groups working with lenders to try to get that trust in neighborhoods where there might be people who would be suspicious of lenders to increase those rates.

But it is a problem, and it needs more and constant attention to make sure that that communication happens sooner rather than later.

The CHAIRMAN. I want to make an announcement, and it may be relevant. The Secretary of the Treasury and the Secretary of HUD did announce a program that the Administration is doing, I think called New Hope, to try and make more of this happen. And we will have a hearing a week from Friday in which we will ask them to report on their progress. Sometimes we find that calling a hearing is more important than having one.

But we will on a week from Friday be expecting to hear from representatives of the Secretaries of Treasury and HUD and others in the Administration on how they have succeeded in doing exactly what you're talking about. Because a lot of the pieces are in place, we are told, and they haven't been connecting.

And one of the things that we hope to do in this bill, and it may not be in here as explicitly as we'd like, is part of the problem is at least once a year, it seems to me, people who have mortgages ought to be notified who it is they are to call if they have a problem. Because with the secondary market and the servicers, etc., some people have a hard time figuring out who it is they're supposed to call. I think we would all agree it would be a good thing in the bill if we were to put some kind of, maybe at least an annual notice requirement.

But we are going to have a hearing a week from Friday in which we expect to get reports from the Administration on the progress of making that work.

The gentleman from Louisiana.

Mr. BAKER. Thank you, Mr. Chairman. Mr. Dugan, focusing on the operational aspects of the bill if it were to become operative, under debt-to-income analysis, is there an established regulatory definition of debt for the purposes of qualifying?

Mr. DUGAN. There is not an established one. I think the bill would have to call for that.

Mr. BAKER. Is there a variance from mortgage originator to mortgage originator in how they look at debts in qualifying an applicant?

Mr. DUGAN. Yes.

Mr. BAKER. So that in one institution, if the mortgage obligation represented 49 percent of monthly income, that would be an acceptable qualified borrower. On the other hand, if the same borrower went to another institution and had credit card debt, student loans, other monthly obligations of a stipulated regular amount, he would therefore not qualify at the second institution?

Mr. DUGAN. Yes. You definitely can have those variations among—

Mr. BAKER. Is there a regulatory definition of what income is constituted? For example, are trust fund payments necessarily part of the calculus for income?

Mr. DUGAN. We have not established any specified debt-to-income ratio that's mandatory to begin with, so we haven't established it for the components either.

Mr. BAKER. Is it customary know some markets for people who are not low income, not average wage earners, but upper income individuals who have no record of credit default or other impairments to their credit record to have a portion of their monthly income in excess of 50 or 60 percent because of the high cost real estate markets in which they reside? As, for example, in New York, where I'm told about 29 percent of upper income wage earners have mortgages which are in excess of 50 percent of their monthly income?

Mr. DUGAN. Yes, that is correct.

Mr. BAKER. In your view, then, would that market effect be to exacerbate the problem that many members of this committee have expressed, which you may not be aware of, about the difficulty in some individuals getting access to mortgages enabling them to acquire a home in high cost real estate markets, wouldn't this further aggravate that ability to acquire homes if the 50 percent rule becomes operative?

Mr. DUGAN. That is a potential concern.

Mr. BAKER. Do you have a view of how the secondary market works today with regard to the HOEPA market loans? Is there a broad and deep liquid HOEPA secondary market?

Mr. DUGAN. No there is not, as I mentioned earlier.

Mr. BAKER. And to what do you attribute that?

Mr. DUGAN. Well, I think that because of the—it has become something of a scarlet letter, the designation of being a HOEPA loan.

Mr. BAKER. So that would be related to reputational risk?

Mr. DUGAN. In part.

Mr. BAKER. In that case, were we to be concerned and act appropriately to weed out those who took advantage of particularly low-income home buyers by licensure of mortgage originators, which I believe the bill does provide, by standards of suitability which I believe the bill does provide, wouldn't those steps necessarily be a better tool, given the strength of the regulatory backstop, of course, to enforce the matching of customer with financial product than arbitrary limits which are not defined relating to debt and income?

Mr. DUGAN. Well, those standards that you've just described are not objective standards.

Mr. BAKER. Understood.

Mr. DUGAN. And we have some concern from that standpoint about, if you're talking about something that, you know, must be in the interest of the consumer—

Mr. BAKER. Well, let me rephrase it. Isn't there a better way to describe suitability than necessarily just debt to income?

Mr. DUGAN. Well, it sort of—I guess what we had thought on the duty, what we did—the federal banking agencies, when we did our guidance, questions were raised about suitability, and I think based on the comments, we decided the better way to address it would be through an ability to repay standard as the real focus and the objective focus about underwriting at the fully indexed rate. And that would get at the question.

Mr. BAKER. Good. Because I understood it in an earlier response, you don't have a definition of debt today. And there's no regulatory definition for the purposes of qualifying—

Mr. DUGAN. In the guidance that we did on subprime lending, we did define.

Mr. BAKER. And how was that defined? In simple terms.

Mr. DUGAN. I'll have to get back to you on the exact contours of it, but we did take into account the—in terms of what the—I do remember that it included the principal and interest payments on the loan as well as taxes and insurance, the so-called PITY calculation, was the debt that we were talking about.

Mr. BAKER. Well, for the purposes of the committee's work—since my time has expired, Mr. Chairman, I'll wrap up—I would very much appreciate a description of the technicals that go into the determination of a person's ability to qualify for a mortgage product and what, if anything, relates to the suitability of that product to that particular applicant's financial circumstance. In other words, help. I don't think the consequences of the bill as proposed, although not intended, are going to be positive, I think it will restrict the flow of capital to low-income individuals, but also to upper income who happen to be aberrantly high in mortgage payments in relation to income, and there has to be a way to fix this. And so I would urge your assistance in seeking that remedy.

Mr. DUGAN. Okay. We would be happy to follow up. Although what I would say is that we don't focus so much on suitability as ability to repay. That's the standard.

Mr. BAKER. I understand. But that's our problem.

The CHAIRMAN. The gentleman from North Carolina, a co-author of the bill.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. Mr. Chairman, I've served in Congress for almost 5 years now and served on this committee for almost 5 years. I've worked on this issue for almost 5 years. It is stunning to hear the same rote repetition of talking points that we've been hearing for 5 years. The very same arguments, with little more support than they have had all along, and based upon the prepared testimony submitted in advance, very little different from industry as well.

According to the New York Times, by the end of President Bush's Administration, 700,000 fewer American families will own their homes than did at the beginning of his Administration. According to Lehman Brothers, 30 percent of the subprime loans entered last year will end in foreclosure. Not dip into foreclosure, but end in foreclosure.

The Center for Responsible Lending estimates that 2.2 million American families will lose their homes to foreclosure in the next year or two. We already have the highest foreclosure rate that we've had in 25 years, and we will soon have the highest foreclosure rate since the Depression.

It seems like there ought to be some acknowledgement that we have a problem. I didn't really expect that there would be rending of garments and gnashing of teeth at the hearing today. I really didn't think that industry would come forward and acknowledge their manifold sins and wickedness, but I expected some acknowledgement of a problem and some acknowledgement of responsibility for the problem, some acknowledge that it was lending practices that put us where we are now, with millions of Americans falling out of the middle class into poverty because they've lost their homes to foreclosure.

A couple of the Republicans, including Mrs. Capito, have talked about North Carolina's law and said that we don't want to repeat the experience of North Carolina. That there had been fewer loans in the subprime market after North Carolina passed its law. The Commissioner of North Carolina banks, Joe Smith, has sat there at that table repeatedly and testified that since North Carolina adopted its law in 1999, there has been no diminution in the availability of credit in the subprime market. None. He can't find anybody who should be able to get a loan who can't get a loan.

The business school at the University of North Carolina has done a study and found no diminution of credit in the subprime market. An industry publication, Inside B&C Lending, looked at lending in North Carolina, subprime lending in North Carolina, and subprime lending in other States, and found no difference in the availability of credit or the cost of credit. Are you aware of any study that finds that credit is less available in the subprime market in North Carolina because of the consumer protections of North Carolina? Any of you?

[No response]

Mr. MILLER OF NORTH CAROLINA. Okay. Now there may be fewer loans. That's not an unintended consequence. That's an intended consequence. One of the characteristics of predatory lending is to trap people in a cycle of borrowing so they have to borrow again and again, and they can't pay their loan. They have to borrow again. They have to pay a prepayment penalty to get out of the last one. They have to pay costs and fees to get into the new one, and they systematically are stripped of the equity they had in their loan. If there are fewer loans being made in North Carolina, that's what we intended. That means the law is working.

Mr. Dugan, I was surprised by your concern that some of what is in this law is a subjective standard. The law is filled with subjective standards, as you must know. There was a great old English common law case that fraud can have no all-embracing definition lest—that the fraud is better left undefined lest the craft of men should find a way of committing fraud that might escape a rule of definition. That pretty well tells you the reason for having some subjective standards, so that there's not a way to get around it.

And now we've heard from industry they want bright line, clear rules, but they want to maintain market innovation. That's what worries me. They'll innovate their way around anything that we do. Mr. Dugan, are you not familiar with the idea of the reasonable man rule in law or proximate cause in securities laws, suitability standard, know your customer requirement, churning, all of those subjective standards? Has the securities law not worked because it has subjective requirements.

Mr. DUGAN. I never said that I wasn't aware of subjective standards in the law or that all subjective standards were bad. What I said was that there has been a huge problem in the subprime market. The bill imposes a duty of care that applies to all mortgage providers, not just subprime mortgage providers, with a subjective standard. And my point was only that when you have a subject standard and the penalty is litigation, you're going to get a lot more of it.

Mr. MILLER OF NORTH CAROLINA. Well, if it is true that they want to make sure that we protect market innovation and they continue to innovate, how can we come up with an all encompassing objective standard that they can't innovate around?

Mr. DUGAN. Well, as I said before, I think to me, the most important standard that's being put in the bill that's being discussed is the ability to repay, to make sure that these loans are underwritten at the ability to repay based on verified income, which as we talked about earlier, something that we support in our own guidance.

There are a number of specific standards that are in the bill that do those things. And what we were just talking about is a subjective standard on top of that that extends well beyond subprime lending. And that, I think the former way is in my view a better way to get at those issues.

The CHAIRMAN. The gentleman from Georgia.

Mr. PRICE. Thank you, Mr. Chairman. I want to thank every member of the panel for their perseverance and for their patience in both our schedule, and the level of interest in this issue is significant, huge issue for so many folks across this Nation.

Coming from Georgia, I would—I don't know exactly what happened in North Carolina, but I do know that in Georgia, intervention by governmental entities can significantly alter the availability of capital and dry up capital for folks who are interested in purchasing homes. We saw that 4 or 5 years ago with changing assignee liability. And literally overnight, the people who wanted to be able to purchase homes were unable to find capital to purchase homes.

So we can go too far. I haven't heard, I don't think, enough of that sentiment from folks who just 6 months ago or so we heard essentially all that sentiment. Mr. Antonakes, you said in our March 27th hearing, "at this time we don't see the need to ask Congress for additional authority or additional legislation, regulation appropriately deal with the issues."

The Fed reiterated that. The OCC said we agree. We believe the nontraditional guidance the agency has issued in October as well as the subprime guidance that we now have out for comment uniformly implemented by all regulators along with the natural operation of the market is all we need right now. We don't think we need anything else.

The Thrift said I've expressed some support to take our guidance to subprime lending and make it a standard would apply to all institutions.

So I guess I'm a little surprised by the testimony that I heard this morning, and I would ask what happened? How—what's the current lovefest now with the Federal Government getting involved in the federalization of home mortgages to a greater degree? Please?

Mr. DUGAN. Well, I think what at least we at the OCC have always testified is that we did and continue to think that the guidance that we issued is adequate for the banks that we supervise. But what we have always been concerned about is that same standard would be applied across the board to the less, what we believe is the less-regulated entities at the State level. And in my view, and as I said before, that's why you need some kind of uniform national standard.

Now that can be accomplished by States adopting the Federal guidance, and many States have been doing that. It could also get there through Federal Reserve rulemaking to a large extent under their HOEPA authority, or you could get there through Federal legislation. Whichever way you choose, we do believe that there ought to be an even level playing field, a national standard.

Mr. PRICE. And I appreciate that, Mr. Dugan. In your testimony, you said—because I was struck by it, "some creditworthy borrowers would be denied loans." I think that's a message that hasn't gotten out. Remember, this bill that we're looking at doesn't apply to the folks who don't have any problem getting credit. It doesn't apply to the folks whose income is such that they don't get to that level where they have to come under cause for concern by our friends who want the government to be able to make their decisions instead of themselves.

So it applies to those folks who are at the margins and are trying their best to get into a home. Yet what you have testified to, which I strongly believe would be the case, is that some creditworthy borrowers would be likely to be denied loans. So where is it that we go too far in making it so that those folks who are trying to live the American Dream, who are trying their best to work hard, to provide for their families, who have the dream of getting into their own home, but we at the Federal level say, oh, no, you really don't know. We can make a better decision for you. Just trust us. Trust us. We'll make a better decision. Where do we step over that line?

Mr. DUGAN. Well, as I testified, I think there are some places in the bill that go beyond what the Federal agency standards are. But I will say that any time we draw standards that are intent to reduce the supply of credit to, in cases where there have been abuses or problems, you run the risk of also reducing it to some creditors that would be eligible for it. And when we enacted our guidance, we believed that the situation had gotten problematic enough that it was worth taking that risk with respect to certain categories of practices. And I think that's the same animus that's driving the legislation.

There are some places where the categories in the safe harbor in the bill go beyond what our guidance does. And personally and from the OCC, I'd like to—we'd like to see some adjustment to some of those things, and we'd be happy to provide some of those more detailed comments to the committee, as the chairman has invited us to.

In addition, the bill does provide the regulatory agencies the power to make some adjustments to categories over time, which I do think, if the committee does go forward with this legislation, it's very important to have that authority not only put in the legislation but described in a way that makes sure that regulators do feel free to make adjustments that they believe are appropriate.

Mr. PRICE. My time has expired, Mr. Chairman. Thank you.

Mr. GREEN. Thank you, Mr. Chairman and I thank you and the ranking member for holding this hearing. It is exceedingly important that we talk about these issues, and I thank the witnesses for appearing today. To provide some additional input, permit me to ask, is there anyone among you who believes that the subprime market is overregulated. If you think it's overregulated and that we are about to do a disservice by imposing some, what I call sensibility, kindly raise your hand. Anyone think the subprime market is overregulated?

All right, now, is there anyone who is of the opinion that the subprime market—this is by the way, in court called voir dire—it's a French term—meaning to speak the truth. So, this is a truth-telling portion of this hearing for you. Is there anyone here who believes the subprime market is underregulated? That we ought to do something about some of the concerns. If you think it's under-regulated, I hate to have you do something as simple as raise your hands, because it sometimes appears to be childish, but would you raise your hand if you think it's under-regulated?

The CHAIRMAN. The gentleman, help out the recorder, for the benefit of the record.

Mr. GREEN. Thank you, Mr. Chairman. You were a great trial lawyer in a previous life, obviously. Because people who read these records have no way of knowing what actually occurred, it is incumbent upon me to ask the recorder to note that all persons have raised their hands, unless I have missed someone. All persons have raised their hands, connoting that the subprime market is not under-regulated.

Now, given that it's not under-regulated, and given that Congresswoman Waters went through quite a list of things that are of concern, from pre-payment penalties to teaser rates that don't properly adjust such that you qualify for a teaser rate, but you don't qualify for the adjusted rate—she went through a number of things. Congress has to do something about this.

We really, in my opinion—well, let me just ask. Is there anyone who thinks Congress should take, not a laissez faire attitude, but a lazy attitude, and do nothing? If you think that we should do nothing, raise your hand. All right, looks like we opted—there's one person who thinks maybe doing nothing is good. Governor?

Mr. KROSZNER. I don't think doing nothing is good and that is where the Federal Reserve is going to exercise the power that Congress has given it, to write HOPEA rules addressing many of the issues that have been raised.

Mr. GREEN. Governor, let me be very pointed. Are you of the opinion, Governor, that Congress should do nothing about the prepayment penalties, about the teaser rates, and not qualifying for the adjusted rate, about the whole notion that persons are put into loans and some cases where in persons who are making—originating the loans are aware that they cannot make the notes at some point where there's an adjusted rate—do you think that we should do something about this?

Mr. KROSZNER. These are real challenges and these are things that you have given the—

Mr. GREEN. Sometimes when folks finish, I don't know if they have said, "yes" or "no." So I have to ask you, would you kindly say yes or no. Should we do something about it?

Mr. KROSZNER. If you can do it in such a way that it doesn't restrict responsible lenders from running credit that can be used responsibly, then you should do something about it.

Mr. GREEN. Okay. All right, everybody can qualify, but we all agree that there's a role for this—for Congress in this process. And if Congress should do something about it, we have to get beyond this notion of, as my grandfather who is a Methodist minister would put it, wanting to go to heaven but not wanting to die. If you want to get to heaven, the only way you can get there—there's one way. Nobody goes without—that's the way it happens.

So, given that we all want to get there, then Congress has to do what's known as "bite the bullet." We really do have to make the hard decisions about some of the things that everybody wants to see regulated or something done about, but few people—not enough people have the courage to step forward and try to make a difference.

So, I am just going to beg that persons understand—as my time is running out—that we have difficult decisions to make. But this is why we get the big bucks, to make the tough decisions and go back and face the crowd and say that we did what we thought was appropriate under the circumstances prevailing at the time. My final question is this—because there's some question about people changing their minds.

My suspicion is that at one point some of you believed in the Easter Chicken, also known as the Easter Bunny. And at some point, my suspicion is, you changed your minds and you no longer believe in the Easter Chicken. If you still believe in the Easter Chicken, raise your hand.

Okay, it's pretty obvious, as we mature and as we receive additional empirical evidence, we ought to have the maturity to change our minds, and do what is appropriate given the new evidence that we have acquired. I thank you, those of you who have metamorphosed into better people. God bless you. I yield back.

The CHAIRMAN. The gentleman from Connecticut.

Mr. SHAYS. I'd like to note for the record that my colleague didn't point out to the transcriber how many people raised their hands about the Easter Chicken. I think there was one and it was a Member of the House. Would the gentleman—I don't want to use my time.

The earthquake hit last year, at the end of last year, beginning of this year. When does the tidal wave hit the foreclosures? What quarter are we going to see a lot of foreclosures? I'd like to ask each of you. Let's go right down. Your estimate of when you're going to see the largest number of foreclosures.

Mr. GRUENBERG. Congressman, I think we're actually entering that period now. I think the large volume of the subprime, hybrid ARMs, these 2/28s, were made in the last quarter of 2000—

Mr. SHAYS. I have 5 minutes, so you think it's—

Mr. GRUENBERG. —started last quarter 2005, 2006.

Mr. SHAYS. That was the earthquake. I want to know when the tidal wave hits.

Mr. GRUENBERG. This quarter and into next year is probably going to be the peak.

Mr. DUGAN. I would agree. I think September had the highest monthly volume of resets but that high volume, even though it's a little bit large, extends right up through next year. So, through next year I think is the—

Mr. REICH. Second to third quarter of next year.

Mr. SHAYS. Thank you.

Ms. JOHNSON. We would say through the middle of next year.

Mr. KROSZNER. I'd agree, through the middle of next year.

Mr. ANTONAKES. I'd agree as well.

Mr. SHAYS. Thank you. If people started to—and banks, with their customers, started to renegotiate the terms of the loan, could that make a noticeable difference on what happens next year?

Mr. GRUENBERG. As you know Congressman, most of these loans are held in securitizations, that is the real challenge here, and I think what is probably needed is a broad effort by the servicers who are responsible, for most of these loans to modify as many as possible so that you can have long term effects for the homeowners.

Mr. SHAYS. Any other comment?

Mr. DUGAN. Yes, modifications could make a very significant difference.

Mr. SHAYS. Okay, but the challenge would be what—getting the institutions to identify themselves and identify who their customers are?

Mr. DUGAN. No, it's not a question of identifying who the customers are, it's often getting the customers to acknowledge and to work out a different modification rather than just not paying on time, partly. And partly it's a systemic issue. We have high volumes of figuring ways to do that that are more efficient.

Mr. SHAYS. Let me just, so I am sure I'm understanding what you're saying—the institutions themselves would have a lot of customers to renegotiate with and maybe not be able to handle the volume?

Mr. DUGAN. The servicers.

Mr. SHAYS. The servicers. Thank you, okay. Basically, we had homeowners—we had renters encouraged to buy and we in Congress took great pride that we were seeing minorities have ownership that they didn't have before and a good chunk of it was with the subprime market. I'm told that people who practically couldn't even afford a second month payment in rent could end up buying a house under the subprime market.

If that's true, without sounding insensitive, when there is a foreclosure—in a sense did these individuals really ever own the home in the first place. And the question is, should our effort be to try to help them keep the home or is it in their best interest not to own it?

Mr. GRUENBERG. Congressman, I think it's important to keep in mind that the majority of the subprime mortgages were refinancings by existing homeowners and the issue really is that for many of these people, they had mortgages they could afford to pay. They were encouraged to refinance into mortgages that they cannot. And that's part of why this is such an urgent—

Mr. SHAYS. Would you all agree with that? Because that's something I think is quite significant.

Mr. DUGAN. I think there is a huge part that is refinancing, but getting back to your question, but I do think that not every loan should be restructured. Some are going to have to be required foreclosure because some people can't afford to make the payments on the loan even on a restructured basis and foreclosure is the only option. No one wants that, but in some circumstances that will be the case, for the very reasons you suggest.

Mr. SHAYS. Does anyone disagree with that?

Mr. REICH. I would add that I think—I would perhaps oversimplify that there are perhaps three categories of borrowers in the subprime arena. One would be investors who had no intention of ever occupying the property. The second would be people who were misled by the products they got into. They thought they could afford it but they didn't fully understand the terms and the third category would be those people who thought they understood the terms but ultimately did not realize that the rate resets would be taking place.

The CHAIRMAN. Thank you, gentlemen. We have heard the bells. I'm going to—I think we can get in these two last sets of questions and we can dismiss this panel. So, we'll go to the gentleman from Missouri first and we can move quickly. We are going to have a problem.

Mr. GREEN. Mr. Chairman, may I ask for unanimous consent to insert into the record a letter from the National Fair Housing Alliance?

The CHAIRMAN. Yes, without objection. I also have a letter from Countrywide responding to some accusations made about them at our last hearing, which will be put in the record, withouot objection.

The gentleman from Missouri.

Mr. CLEAVER. Thank you, Mr. Chairman. I'll be very quick. There are—I met with some of the people from the financial industry in my home district in Kansas City, MO, and they seem to believe that if we bring forth some new regulations, that somehow the credit crunch will be exacerbated. Do any of you agree with that? To bring on some regulations with regard—similar to that which the Chair and Mr. Miller are proposing, that it creates a greater credit crunch?

Mr. REICH. Well, the devil is in the details, Congressman. It depends upon, ultimately, what the legislation looks like.

Mr. CLEAVER. Okay, so, do you think it—would you agree with the editorial writer in today's Wall Street Journal, that this would give delinquent mortgage borrowers a new trick to essentially enjoy free rent for up to 30 years?

Yes, sir—

Mr. GRUENBERG. I wouldn't agree with that, Congressman.

Mr. CLEAVER. Mr. Comptroller.

Mr. DUGAN. I think the issue with—it goes back to some of these questions about suitability and the details of the legislation. The concern is, could people avoid making payments on loans by inserting defenses that would otherwise not be available? I don't think that's the intent of the legislation. I think there's an effort to work with the language to prevent that.

Mr. REICH. To be honest with you, I didn't fully understand your question. I'm sorry.

Mr. CLEAVER. Okay, because my time is running out. Thank you. Ms. Johnson?

Ms. JOHNSON. I haven't read the editorial that you're speaking to and that line taken out of context so I'm not sure that I could provide an answer.

Mr. CLEAVER. Governor?

Mr. KROSZNER. My hunch is that they are engaging in a little bit of hyperbole, but I think it's exactly as we said before. It really depends on the specifics of the legislation and we'll craft it narrowly focused—legislation addresses things like, well-crafted—repay that we could do through our Hope Regulations could address some of these issues.

Mr. CLEAVER. Commissioner?

Mr. ANTONAKES. And given the way the legislations draft and with the rulemaking process, I think that unattended consequence would be avoided.

Mr. CLEAVER. Thank you.

The CHAIRMAN. I thank you and I just would say that my attention was called to the Wall Street Journal editorial and the notion that somebody could get a 30-year stay here is, even by their standards, extremely bizarre. The gentlelady from Wisconsin.

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chairman, and I'll be brief, given the time. As I listened to the testimony, particularly the last comment by Director Reich, I believe it was, you talked about people who typically default on these loans as investors who never intended to occupy it, people who didn't understand the terms and conditions, people who thought they understood, and it really doesn't place any liability.

Those comments are the people who are putting the products out, it's just consumers are just too dumb and I'm saying that because I am—I believe I'm a cosponsor of the chairman's bill and I was—I along with Mr. Hodes, another member of this committee. We have put a bill together that we think addresses some of the other—another problem with the way these loans are written. People in the mortgage broker industry, unlike prime loans, are not required to include escrow accounts.

So, you can write up a loan that people think they can afford. You know, they're going to pay $700 a month, but they don't have property taxes and escrows and other important escrows and at the end of the year suddenly they are hit with a huge—$2,000 or $3,000 tax bill and they're being foreclosed on. I'm wondering if you think that it would be a sage and wise thing to include that in there.

I'll tell you, I am one of the people who believed in the Easter Bunny, sorry. Because I have to boil up several dozen eggs every year and I have to believe in the Easter Bunny. But there are people who will argue that they don't need the bank to handle their money in an escrow. That they can use those monies themselves to invest.

But given the nature of subprime loans, I'm just wondering if the panel thinks that it wouldn't be wise, given that there will be some sort of legislation to include the requirement: number one, that escrow accounts be included in the loan; and number two, that a second provision of our bill would be to require them to use licensed appraisers and not just mortgage bankers who are out there trying to get the value to fit the kind of loan they want to make.

Mr. REICH. I absolutely believe that there are many good things in this bill, including the requirement that principal, interest, taxes, and insurance be required for loans to subprime borrowers.

Mr. DUGAN. I actually don't think that requirement is in the bill.

Ms. MOORE OF WISCONSIN. It is not. That's why I'm saying, I'm proposing. I—

Mr. DUGAN. I would agree with that. To be honest, I was a little surprised it was not in the bill.

Ms. MOORE OF WISCONSIN. Right.

Mr. DUGAN. But I think that in the subprime market, escrowing for principal and interest, I think would be a sensible addition to the bill.

Ms. MOORE OF WISCONSIN. Did you hear that, Mr. Chairman?

The CHAIRMAN. Well, if the gentlewoman—also in the bill that Mr. Kroszner filed and I said earlier that I thought we could go ahead with that. So, we did touch on that earlier and I think in fact one of the witnesses, Chairman Johnson, did also allude to that in her testimony and I plead guilty to the charge of under-regulating and I'm prepared to adjust my habits and regulate some more. The gentlewoman is recognized.

Ms. MOORE OF WISCONSIN. Thank you, I think I will yield back, given—

The CHAIRMAN. Thank you. We will now go to the gentleman from California, and then we will dismiss this panel. As the last thoughts of the day, I plan to stay. This is very important. Some members will be back, staff will be here. I apologize to those who will be testifying later, there will be fewer members, but it will have no less impact, I assure you, on this important deliberation.

The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman. I commend you for stating that the credit union regulators should also have a seat at the table in drawing up the regulations. I think the bill is something I should commend you for. Particularly the concept that we should make sure that the borrower has the ability to pay. I commend the gentlewoman from Wisconsin for bringing up the idea that property taxes and insurance principal and interest need to be factored in in determining ability to pay. And I hope that we would specify in the bill, when we talk about ability to pay we mean from current income and not based on—yes?

The CHAIRMAN. The requirement of all the costs—principal and income, etc., is in the bill. What's not in the bill is the escrow and the appraiser. Those are the pieces—the full cost piece is in the bill, the appraiser and escrow is what would be added.

Mr. SHERMAN. I thank you for setting me straight. I thought it was in and then I heard that it was out and thank you for letting me know that at least full costing is in—

The CHAIRMAN. I'm kind of an expert on what's in and what's out.

Mr. SHERMAN. That may be, but—compared to me, you are. And I hope that we would specify in the bill that when we're looking to document income, if somebody is a wage earner they have to provide that W–2 form or their full tax return. If somebody's claiming investment income, that they have to provide the 1099s or the full tax return and if somebody's claiming self-employment income, they have to provide their full tax return.

I realize that up until this year we might have taken the idea—let the regulators just put in all the specifics, but I would hope that we would put those specifics in the bill. The bill provides a floor, a minimum Federal regulation without a ceiling and therefore we don't end up with a national standard. And I realize that time is running out, so I may just ask you to respond for the record, but if there's one witness who wants to respond:

Do we need, in order to have efficient nationwide capital markets, to become the ultimate owners of these mortgages, a Federal standard? Perhaps with a few things that some States could opt in or out of—opt out of. Or could we really have the benefits of a national securitized market and have every city and State free to impose its own rules? I don't see anybody really anxious to give an oral response. How many more minutes until the bell? Why don't we just take a response for the record?

The CHAIRMAN. Okay, I thank the panel. This has been very useful and and I appreciate the degree of specificity. The gentleman from North Carolina asked for that and I think it came a little later than he had asked for it, but it came and we will be really keeping track of these things. And I think we have set a good context in which we can make some movement and move some pieces around and come up with a consensus bill. The hearing is recessed and we will resume right after the votes with a second panel.

[Recess]

The CHAIRMAN. The hearing is reconvened. Under other circumstances, I would apologize for the delay, but I do think this has been useful. I think it has been very helpful to have all of the people who have an interest in this bill spending a day thinking about it, and listening to each other.

We will move more quickly now, obviously, because there aren't going to be a lot of members asking questions, so we can probably finish this in a couple of hours. The House is adjourned for the day, so we won't be bothered either by votes or by members who aren't paying serious attention disrupting things because they have nothing else to do.

We will now have a serious conversation with people who have a great interest in this bill, and I think that will be useful. We will begin with our next set of witnesses. Let me get the witness list.

We will begin with Michael Calhoun. He is the president and chief operating officer of the Center for Responsibility Lending. Obviously, without objection, all material that witnesses want to submit will be put into the record. I will say this: There is no need either to thank us for having this hearing or to summarize the bill. Just get right to it.

Mr. Calhoun.

STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT AND CHIEF OPERATING OFFICER, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. Thank you, Mr. Chairman. It may be fitting that the three sponsors are the ones here now.

I am going to address my comments first to talk about the assignee liability, which has been one of the key comments. I am going to try and follow my Congressman from North Carolina, Mr. Watts', admonition to be specific. And then I will address the North Carolina experience as it relates to this bill, and the specific provisions of this bill, finally.

First, I think it is very important to set straight for the record what this secondary market responsibility or assignee liability is and what it is not. First of all, assignee liability is a common feature of the law. In contracts in general, including in mortgages, presently, under present law, the Uniform Commercial Code provides assignee liability for holders of mortgages and other negotiable instruments who are not so-called holders in due course.

You also have substantial assignee liability, including for mortgages, under the Federal Trade Commission holder rule whenever you have a home improvement loan. And you also have significant assignee liability for credit transactions, including mortgages, presently under Truth in Lending. And the market absorbs and deals with that liability well without either raising the cost or reducing the accessibility of credit.

What assignee liability is not is liability to the individual bond holder. No one has proposed that, and that has never been a component of assignee liability under any of the State laws or the Federal bills.

Finally, it is important that we are not talking about leaving the secondary market out there alone holding all the liability for these loans. In every sale of mortgages, the purchaser requires the lender, or if it is a later seller, to represent and warrant that the loan was made legally, and that if there are any violations or liability, the seller of the mortgage has to indemnify the secondary market holder for that liability.

And so the secondary market not only deals with assignee liability today, it is in a position to manage it and to recover from those who sell them the loans, and the liability goes back down through the chain to the original lender or originator who engaged in the illegal conduct.

Second, I want to address a couple of aspects of the North Carolina experience and bill since it is used as a model for this. I think it is relevant to a number of the issues here, including preemption.

In 1999, the North Carolina bill was enacted and which addressed—it was the higher cost loan sections addressed to equity stripping. It initially did not cover open-end loans, and so quickly some lenders converted all of their mortgages to open-end loans, thus evading the coverage of that bill just as they evaded coverage of current HOEPA, which does not cover open-end loans. North Carolina came back in 2001, added open-end loans with the agreement of the industry, and that became a model also for other places around the country.

Five years ago, these so-called 2/28s were not the exploding ARMs that they developed into. Originally, the payment reset was small because the Federal discount rate was so low and rates were derived from that. There was not the large payment shock. That really developed starting when the Federal Reserve engaged in the quarter point march of interest rate bumps.

And so in 2005/2006, we went to lenders and said, "Do you realize the built-in payment shocks that these loans have, and are you truly going to try to underwrite them based only on the original payments?" I think the response carries an important message. Several of those lenders said, "We agree these are problematic loans and would prefer not to be buying them."

But we cannot unilaterally impose those standards on the market because if we do, the originators, typically the brokers, will take all the business down the street. Most of these lenders got—for example, New Century—90 percent of their volume from mortgage brokers. If they said, we are not going to take the loan that you want to sell to us; it is most profitable to you, New Century loses all their business and it goes down the street.

I think a couple lessons there are this market will evolve. You need to leave States the ability to respond. And also, a specific provision, Title 1 and Title 2, do not currently cover open-end loans, and we would recommend that they do so as the North Carolina law does, both the original predatory lending law and the additions that were made this last summer, which have been incorporated in substantial respect into the bill.

Finally, I want to say there are very many good provisions in this bill. It takes the right approach of trying to restructure the market. The real concern we have is that we have thrown the baby out with the bath water, and that is the baby of effective enforcement.

In many circumstances in this bill, the only remedy a borrower has is a very limited right after the loan goes into foreclosure, and they are left effectively with little or no remedy until the loan goes into foreclosure. Forcing borrowers to that does not seem to be the incentive that we want in the bill.

We would urge that the remedies in assignee liability be increased but still moderated, moderate with caps both as to limitations to individual actions and caps on damages. But in many places in the bill currently, there are no effective remedies for borrowers, which means that—this market is bigger than the stock market. There are hundreds of thousands of mortgage brokers. In the last few years, there have been 3 million subprime loans each year.

The only way this bill works is with the market self-policing. And there need to be incentives in the form of remedies and secondary market responsibility or you will not have that policing. Thank you.

[The prepared statement of Mr. Calhoun can be found on page 167 of the appendix.]

The CHAIRMAN. Next we will hear from Janis Bowdler, who is a senior housing policy analyst at the National Council of La Raza.

STATEMENT OF JANIS BOWDLER, SENIOR HOUSING POLICY ANALYST, NATIONAL COUNCIL OF LA RAZA

Ms. BOWDLER. Good morning.

The CHAIRMAN. Good morning, we wish. Good morning.

Ms. BOWDLER. Oh, good afternoon. Clearly I didn't have my second cup of coffee today. Sorry about that. Janis Bowdler. I conduct the research around housing policy issues at the National Council of La Raza. And I was going to start by thanking everybody here, but since I have been directed to skip the formalities, I will do that and get right to it.

NCLR is happy to be at this table. For years, many of you have heard us. We have been to visit you. We have been talking about the fact that Latinos are getting bad loans. Even as we convene today, thousands of families are faced with the nearly insurmountable task of saving their home from a foreclosure spurred by a predatory loan.

What NCLR is trying to do in this debate, and what we wanted to accomplish here, is really to level the playing field for Latino borrowers. We have conducted research. We have listened to the stories of borrowers. And we have even gone out and interviewed practicing mortgage professionals. And this intelligence is the underpinning of our policy agenda to improve the mortgage market for Latino families.

This bill, H.R. 3915, is the first one we have seen that directly addresses several key Latino priorities. And we would really like to commend the authors and their staff for their hard work and diligence on this bill. In my brief time this morning, I would like to highlight a couple of key provisions that are important to Latino and immigrant borrowers. And we also want to offer some suggestions on how we think it can be strengthened.

But I am going to start where I normally do, which is to talk about the borrowers. And I want to tell you a story about Mr. and Mrs. Silva, who actually purchased a home in Lawrence, Massachusetts. They had solid credit histories and stable income, and they purchased a home at the top of their purchase range.

They didn't find out until much later that the appraisal was inflated, the title work was incomplete, and much of the construction on their new construction home was shoddy. In fact, they figured it out about the same time that they realized that they had an unaffordable 80/20 loan with a reset looming on the first loan in the near future.

The story is a familiar one by now. Their broker assured them they had a fixed rate loan. The inflated appraisal limits their refinance options. And no one involved in the transaction was willing or able to help them. Nobody is accountable.

Housing counselors across the country are operating at maximum capacity, but we are still swamped with calls. In fact, NCLR has been receiving calls directly from consumers, and two things are clear: The market isn't correcting in a way that helps borrowers; and system-wide protections are necessary to prevent predatory behavior. We think that several of these protections are in H.R. 3915.

Briefly, the bill has a strong anti-steering provision. We are excited to see that it would eliminate compensation-based incentives to steer families to expensive or risky loans, and sets the stage for additional prohibition on actual steering practices.

The bill also puts forward an aggressive strategy to license and regulate originators. This summer, NCLR partnered with NAHREP to interview mortgage brokers serving the Latino community, and the response was overwhelming. The brokers told us that they wanted to be regulated. They were tired of getting a bad rap. They were tired of seeing their own customers get steered towards bad loans by unethical brokers. And they want more accountability.

H.R. 3915 also lays out a common sense ability to repay standard. Lax underwriting standards and unaffordable loans are at the heart of predatory lending, and if such a standard had been in place, the Silvas likely would have gotten an affordable loan in the first place.

We also want to work with members of this committee to continue to strengthen the bill. We are concerned that the bill's enforcement standard falls short. Unless we strengthen these standards, borrowers may not get the full benefit of the other new protections created in the bill.

And again, I expand on these in our written comments. But the first that I want to point out is that the bill does a great job of increasing civil penalties under TILA, but caps it when it comes to the steering provision. This seems arbitrary, and we want to recommend that the statutes stay as is. This would mean the full improved liabilities would apply for steering.

It also extends the right of rescission to include violations of ability to repay and net tangible benefit, and it creates a defense to foreclosure which we support. However, there is an exception that seems to carve out most of the secondary market, and we are concerned that this could have an unintended consequence of setting the borrower up as having to access foreclosure as a remedy, meaning the only way the borrower could access their right to rescind would be in the foreclosure process.

Finally, we believe the rescission right would be stronger if it applied to all harms in the legislation.

Our written statement includes recommendations for improving other aspects of the bill, but I promised to be brief so I will close here. Again, a sincere thank you, and I would be happy to answer any questions.

[The prepared statement of Ms. Bowdler can be found on page 153 of the appendix.]

The CHAIRMAN. The next witness is a familiar face for us and a collaborator on a lot of stuff, Hilary Shelton, director of the Washington bureau of the NAACP.

STATEMENT OF HILARY O. SHELTON, DIRECTOR, NAACP WASHINGTON BUREAU

Mr. SHELTON. Mr. Chairman, I too will avoid the normal process of thanking you and Congressman Watt and Congressman Miller for the great work you did on producing H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, and skip right ahead to the issues.

Predatory lending is unequivocally a major civil rights issue for our times. As study after study has conclusively shown, predatory lenders consistently target African Americans, Latinos, Asians, Pacific Islanders, Native Americans, the elderly, and women at such a disproportionately high rate that the effect is devastating to not only individuals and families but to whole communities as well.

According to a recent study by the Furman Center in New York, between 2002 and 2006, the percentage of subprime loans to African American borrowers rose from 13.4 percent in 2002 to 47.1 percent in 2005. Furthermore, study after study has shown that African Americans and other Americans of color are targeted by predatory lenders and steered into predatory loans at a disproportionate rate regardless of their income or credit history.

These numbers become especially important as subprime mortgage loans become foreclosures. The impact these foreclosures are having and will have on whole neighborhoods and communities, predominately populated by African Americans, Latinos, and other racial and ethnic minority Americans, will be nothing short of devastating.

A report issued last year by the Center for Responsible Lending estimated that one out of every five mortgages that originated during the last 2 years will end in foreclosure. To date, the Federal Government has been largely inattentive to the problems surrounding predatory lending, and in fact, some of the rules and proposals we have seen in the last few years appear to go backward and take away some of the few protections we have gotten at the State level.

This flies in the face of the NAACP's belief that the primary responsibility of the government is to protect its citizens, all of its citizens, not to exploit them or allow them to be exploited for financial gain of a few. As our democratically elected representatives, the NAACP has consistently called on the Congress to enact aggressive and effective Federal law to curb predatory lending.

That is why the legislation we are discussing today, H.R. 3915, is so important. This legislation aggressively addresses problems that the NAACP sees every day, including steering, yield spread premiums, high costs and fees, and prepayment penalties.

The NAACP hears about these abusive tactics all over the country every day, and it is our hope that if this legislation is enacted, we will not continue to hear stories like the one of a woman who called the NAACP national headquarters last month to report that she had been convinced to take out a $30,000 home equity loan, and that $26,000 of that $30,000 loan would go to pay for points and fees. That is absolutely outrageous.

Unfortunately, as the NAACP knows all too well, we must have tough enforcement provisions to ensure that these new laws are adhered to. We cannot allow skirting the law to be seen as merely the cost of doing business. We must make the penalties stiff, and we must show the industry as well as the American public that we mean business.

In addition to a strong Federal standard to address predatory lending, we also believe that States must retain the flexibility to address local and regional issues, and that States can and should be able to address new abusive products that may arise if and when the current problems are addressed. The NAACP believes that any Federal policies that are enacted should be treated as a minimum standard, and that States should be able to enact even tougher laws tailored to address their own unique brand of predatory lending.

Let me close by saying that while the bill being discussed today may not be perfect, we do, however, unequivocally support H.R. 3915. And while we look forward to working with the chairman and others to perfect it and hopefully make it even stronger, we would like to make it clear that we deeply appreciate all that you have done, Chairman Frank, to aggressively address many of the issues at the heart of the predatory lending problem.

I want to thank you again, and I look forward to your questions.

[The prepared statement of Mr. Shelton can be found on page 292 of the appendix.]

The CHAIRMAN. Next is John Taylor, president and chief executive officer of the National Community Reinvestment Coalition, who has been a very active participant in the discussions getting us here today.

Mr. Taylor.

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Thank you, Chairman Frank, and Representatives Miller and Watt, for your leadership on this issue. I am here today to testify on behalf of NCRC, as well as the National Consumer Law Center, and the Rainbow/PUSH Coalition. And rather than repeat some of the points that some of my colleagues have made and that I have made in my written testimony, I would like to take us down a different path.

Two-fifths of the $3 trillion of mortgage loans made in 2006 were either subprime or Alt A. It is estimated now that some 2½ million loans are in danger of foreclosure over the next 2 years. This represents over $300 billion in petition losses to the market. By way of perspective, the New York Federal Reserve Board moved to delay the collapse of Long Term Capital Management because its projected losses were going to be about $3 billion, the Fed fearing that this would have had a catastrophic effect on Wall Street.

The mortgage crisis facing us now represents a hundred times the projected losses of Long Term Capital Management. We are facing a mortgage tsunami unlike any other time in our history, and lest you think I am offering a hyperbole by calling this a tsunami, consider that the number of foreclosures in the next year-and-a-half will equal 10 times the number of homes lost in New Orleans due to Hurricane Katrina.

The average number of foreclosures annually used to be roughly about 225,000 per year. It is estimated that in January of 2008 alone, in that one month, we may equal the number of foreclosures that we traditionally experience in a year.

The contagion effect with these 2 million-plus defaults will have—the contagion effect that these defaults will have on neighborhoods, bank portfolios, existing housing starts, housing prices, the home-building industry, and ultimately Wall Street may pave the way for a deep and hurtful recession.

We find ourselves in this situation for a number of reasons. Most importantly, it is due to the lack of needed consumer protections and vital regulatory enforcement that would have made such practices illegal to begin with. Alan Greenspan called this in his book, this kind of lending, infectious greed and malfeasance. I am sorry Mr. Hensarling is not here because he mentioned Adam Smith in one of his explanations as the basis for why he had problems with this bill.

And it is interesting that Alan Greenspan talks a lot about Adam Smith in his “Age of Turbulence,” his new book. Mr. Greenspan noted that Adam Smith’s answer to what he called the most important macroeconomic question was what makes an economy grow? Adam Smith said it was four elements: capital accumulation; free trade; a role of government; and the rule of law. Smith emphasized that what was critical to these four elements was that every person must be free to pursue his or her own interests, and that this was what in fact would build the wealth of a society.

Men and women are not free to pursue their own interests when unfair and deceptive lending practices are free to take root and strip wealth from the individual. Predatory and usurious lending is the antithesis of capital accumulation. It is capital depreciation.

By free trade, Smith did not mean the freedom to cajole, cheat, and rob unsophisticated homeowners. His free market assumed that competition was always accompanied by honest and ethical dealings. The role of government was to ensure capital accumulation of free trade while staying out of the way of competition. The wholesale lack of regulatory enforcement, coupled with inadequate laws to protect individuals and promote capital accumulation of free trade, now challenge our ability to grow this economy.

Finally, Smith and Greenspan's fourth element for growing the economy was the need for the rule of law, a catchy phrase in recent years in these hallowed halls. In this case, Chairman Greenspan was clear about the meaning of the rule of law as it relates to these issues. The rule of law, is "the protection of the rights in the individuals and their property." The protection of the rights in the individuals and their property.

This bill, H.R. 3915, won't do much for the 2 million homes that are now—2 million families, really, that may contribute to a major economic downturn. But it does represent a substantial and comprehensive return to the economic principles, as espoused by Adam Smith and Alan Greenspan, that we believe are essential to a vibrant economy.

This bill supports the belief that anyone who works hard, pays their taxes, and acts responsibly will have the freedom to pursue wealth for their family and themselves. Removing abusive and unfair lending practices and holding all segments of the capital accumulation system accountable for these practices is simply sound economic policy owed by this government to each of our citizens.

It is imperative that we act now to strengthen H.R. 3915, particularly that we need to ensure that the protections in this bill are accompanied with strong remedies, with substantial and bipartisan support of the Members of Congress and this Administration. Failure to embrace this long-overdue effort would now be a monumental mistake.

I can say with a great deal of certainty that given the magnitude of this problem and the sheer numbers of innocent Americans whose lives and friends' lives have been impacted by this infectious greed and malfeasance, that there will be few congressional districts where this question will be unimportant in the next round of elections.

It is imperative that you strengthen and pass H.R. 3915 in order to return sanity and fairness to our system of home financing, and thereby support our Nation's economic promise. Mr. Chairman, we look forward to working with you and collaborating with you to strengthen this bill and to support the passage of a meaningful, strong national anti-predatory lending bill. Thank you.

[The prepared statement of Mr. Taylor can be found on page 296 of the appendix.]

The CHAIRMAN. Our next witness is Mr. John Hope Bryant, who is the founder, chairman, and chief executive officer of Operation HOPE.

I just wanted to explain. We began with a panel, obviously, of the regulators, who are sort of neutral. We then have a panel of mostly community groups, and then a panel of people from the business side. In each case, I just want to be clear that it has been a practice to solicit from the Republican side a witness. So Mr. Bryant is here in particular at the invitation of the Republican side, and similarly with the third panel.

But we did feel with the regulators, community groups, and the business groups, that we would be getting, with the particular group from the Republican side, a very balanced discussion here.

Mr. Bryant.

STATEMENT OF JOHN HOPE BRYANT, FOUNDER, CHAIRMAN, AND CHIEF EXECUTIVE OFFICER, OPERATION HOPE

Mr. BRYANT. First of all, I want to say I didn't know I was being asked to submit from any side. So it is nice to be here. I am on the American side.

I wanted to first say thank you for having this hearing, and to acknowledge the presence of Congresswoman Maxine Waters and Congresswoman Judy Biggert.

This hearing, focused on reviewing legislative proposals for reforming mortgage practices in the light of the subprime crisis in America, is a critically important if not a historic day. I support the spirit of H.R. 3915 as well as H.R. 1752, H.R. 3017, and H.R. 3019, which together create a responsible floor for the poor.

Let me start by saying that this is personal to me. My family lost our home in South Central Los Angeles because my father did not understand the documents he was signing because, unfortunately, he asked the wrong question. Growing up, I remember the pride I had every week on Friday nights watching my father make a payroll of his cement contracting business from the front door of our home. That was powerful for a son to see.

But after a while, the workers I knew so well would leave our home, and then a mortgage broker, someone I didn't know at all, would show up at the front door, finally convincing my otherwise brilliant father that he could somehow have more while somehow spending less. The result? My dad was left almost completely defenseless in making the most significant financial and wealth-building decision of his adult life, and our family's, too, a decision that in the end negatively impacted my dad and his marriage to my beautiful mom, who genuinely loved him. But in the end, their marriage ended over money. The number one cause of divorce today for all races is money.

Ultimately, decisions made on that day in South Central L.A. had a negative ripple effect years later on my brother, my sister, my mother, and me. You see, my dad ultimately asked this person, this mortgage broker who was disconnected from any responsibility, the wrong question. He asked what was the payment, when he really should have asked what was the interest rate. No one should ever ask what the payment is when there is an interest rate attached.

We lost our home not because my father wasn't brilliant, because he was and is today at 83 years of age, but because my dad was badly represented, he asked the wrong question, and then he signed documents he didn't understand. I suggest a massive overhaul of the mortgage brokerage industry as it relates to mortgage lending, and I would suggest that you restrict, if not eliminate, negative amortization loans, where every payment you make means the broker you get.

My mother's story, oddly enough, ended completely differently. You see, my mom, who worked a regular 40-hour job, was financially literate. My mother worked more than 35 years at McDonnell Douglas Aircraft, now Boeing Aircraft, in Long Beach, and realized early on that it was not necessarily about making more money, but making better decisions with the money you make.

My mom bought and sold five homes, and today is retired and financially independent, living in Texas. In contrast, my dad today is financially dependent, living in a 4-unit apartment building built for him by me and my wife on the very street we grew up on.

Not all children or even most children are financially able to build and pay for a home for their father, nor should they. Parents should be in a position, if and when they can, to accumulate and later, if they like, to pass down assets to their children, not the other way around. Some 20 years later, Mr. Chairman, this negative legacy impact of the subprime mortgage crisis for many Americans, and not just minority Americans, are experiencing this today. And this is why I am so passionate about financial literacy and economic empowerment.

We have helped to educate 250,000 children in financial literacy, created a thousand low-worth homeowners, and helped 85,000 victims of Hurricane Katrina. I think this gives us some context about how people are managing their affairs in this crisis. And I can tell you with confidence they are not doing it very well.

Just one example of this. In L.A., the city of L.A. asked Operation HOPE to partner in a mortgage crisis hotline. We did that, and when we launched it 3 months ago, we received 3,000 calls in the first day. By the second day, we had received 4,000 calls.

Now, to put this in the context of Hurricane Katrina, in our busiest month in our nationwide outreach for Katrina, we received 3,000 calls in a month. So we received more calls in 48 hours from L.A., from Latinos, mostly, than we received in an entire month nationwide in responding to Hurricane Katrina. I agree that this is an economic tsunami.

We will soon roll out phase two, and we will have hearings in California along the same lines soon. But none of this is enough, which is why we need you to act. So here is what I am also suggesting. I am proposing today, and have likewise sent a letter to all of the Federal regulatory agencies you had here today, that the Federal Government establish, possibly through the Federal Home Loan Bank system, a $10 billion loan guarantee fund, structured in many ways like an SBA loan guarantee. Here is how it would be structured.

Number one, it would carry a standing fixed rate of 3 percent, allowing private lenders to add a maximum of 2 to 3 percent at a reasonable fee for administration, overhead, and profit margin. There is a precedent here. After the riots of 1992 in Los Angeles, the Federal Home Loan Bank did something similar to this, $3 billion. That was repaid.

Number two, allow anyone who had paid their loan on time and within the terms of their agreement prior to their rate reset to be refinanced under this new program, the theory being that these individuals were already properly underwritten at the original term and rate as their loans were performing.

Number three, and finally, all new loans would be made at a 5 to 6 percent fixed rate over a 30-year period, and in some unique hardship cases, over a 40-year period. While I am all for free enterprise and capitalism, and we work at making capitalism work for the poor, I do not believe the poor should be subject to interest rate risk, to wild interest rate risk.

This approach has many benefits, one of which is a temporary economic stimulus by adding billions of dollars of new money back into the economy when the mortgage economy seems to be stalling. Number two, this approach could serve as a unique and new opportunity for the credit union industry, as credit unions were not substantially involved in the original problem, several are large enough to make a difference, and because their unique tax structure can afford to make these loans at an even lower price point, making it a win/win for all involved.

On a separate but related note—

The CHAIRMAN. Mr. Bryant, we are going to have to have you sum up fairly quickly, please.

Mr. BRYANT. Sure. On a separate but related note, I would encourage you to push to keep subprime lending, responsible subprime lending, as part of the mix. Subprime lending was not the problem. Irresponsible subprime lending was the problem. And we should work hard not to cut off capital flowing to the poor. Thank you.

[The prepared statement of Mr. Bryant can be found on page 159 of the appendix.]

The CHAIRMAN. Thank you, Mr. Bryant. Let me say first I appreciated in particular your reference to negative amortization because that is a provision that was put into the bill. Our colleague from Illinois and others talked about it. It was one that I think one of the witnesses in the first panel specifically opposed. So we appreciate your talking about the need to deal with negative amortization.

And let me just ask, the problem when your father was misled into signing these documents, when was that?

Mr. BRYANT. That was 20 years ago.

The CHAIRMAN. I think that is important, to show that we are not—and I appreciate that because some people said, well, this crisis is going to work itself out. Don't over-react. But I think you help us understand that we are talking about some structural problems in this industry, and simply waiting it out for a month or two doesn't resolve it. I appreciate that.

Let me ask the—Mr. Calhoun, you did address this some, but the argument that we have heard from some of my colleagues that the North Carolina experience has been kind of a fizzle. Would you address that?

Mr. CALHOUN. Two things. One, in terms of the impact on credit availability, there have been references to there was a slight—it was a range of 3 to 4 percent reduction in lending compared to similar States after the enactment of the North Carolina law.

I think it is careful that you drill down in those numbers because when you break it out into purchase loans versus refinancing, you actually found an increase in purchase loans, and the reduction was all in the refinancing. And again, that is not a reduction in the amount of credit outstanding. It is a slight slowdown in the flipping of these loans, which are typically refinanced—

The CHAIRMAN. Yes. Let's address this specifically because I was asked this: Are you worried? I was told that this would mean fewer loans being made. The answer is, I am not worried. That is why we are doing it. If all the loans that were made should have been made, we wouldn't have a problem. Let's be very clear. The purpose of this is to keep some loans from being made that should not have been made in the first place.

And to the extent that we saw this in the refinance, and Mr. Gruenberg, in particular, I know said, and Mr. Dugan kind of reinforced this, that many of these—a great majority of these loans that went bad were refinancing. Yes, some of these people shouldn't have refinanced. And the bill says that people should not be induced to refinance if they are going to receive no tangible benefit from it.

So to the extent that there was a reduction in refinancing, that is probably a good thing and probably an intended, not an unintended, consequence if what were prevented were refinancings that benefitted only the financing people.

Mr. CALHOUN. I think one of the key things is the bill has now been revisited about 3 times, and every time the amendments and the strengthening of the bill has been done with broad industry support, including that of, you know, several of the major banks in this country. And that applies as well to the changes that were done—

The CHAIRMAN. All right. I appreciate it. Let me ask all of you because many of you are involved, in some cases directly, Mr. Taylor, and in others as advocacy groups, with—this is a bill that is going to help going forward. We have people who are now trapped in these foreclosure situations.

One argument is that by cracking down some on credit and putting in higher standards, we are going to make it harder for people to refinance their way out of trouble. Would you address the extent to which that accusation is valid, that this bill could hurt people's ability to refinance their way out of trouble? Mr. Taylor, let's start with you.

Mr. TAYLOR. So in other words, do nothing to the people who got injured by the system because they got loans that put them under water. And therefore, do nothing because they are going to be further hurt by the system.

I have never heard such ludicrousness in my life. I mean, unless we—first off, this bill is going to prevent the kinds of activity that put those 2 million families in jeopardy. It is not going to do anything to help them get out of jeopardy. It is not—yes.

The CHAIRMAN. Let me ask specifically: Does anything in this bill prevent a refinancing for someone who ought to be able to get access to refinancing if that would help them get out from under something?

Mr. TAYLOR. No.

The CHAIRMAN. Mr. Calhoun?

Mr. CALHOUN. If I can respond specifically, the crisis in today's credit market is—the point that has been made, is due to the absence of standards. If you want to increase liquidity, a pre-condition is you have to put standards in place that will assure the market that these are reasonable loans that will be repaid.

Second, it is just a matter of—if you are in a hole, the first thing to do is stop digging. And refinancing borrowers who are in trouble now into a loan with high fees, prepayment penalties, and steering just makes it less possible for them to have any chance of saving their homes.

The CHAIRMAN. Finally, Mr. Bryant?

Mr. BRYANT. Mr. Chairman, just the opposite is true. First of all, it is not 2 million mortgages on the bubble; it is 4 million because there is another reset coming after this. This is—just the opposite is true. First of all, people are already having a problem refinancing their loans. So it is not like there is a boondoggle of refinancing going on right now.

Number two, this bill will actually create an environment where refinancings can get done because the market does not respond well to a pack of clarity. Right now, there is a cloud in the market. No one is lending anything. There is a crisis in confidence. Everything is locked up. By introducing this bill to the marketplace, you create a floor for which people would know how to operate and know what is appropriate.

The CHAIRMAN. Thank you, Mr. Bryant. I just have one final comment. But I appreciate that point because I think what we are trying to do here is market-enhancing. To the extent that you provide good standards and people can have more confidence, I think it works better.

Let me just address a comment to Ms. Bowdler and Mr. Shelton. One of the things that we are aware of, and Mr. Green mentioned this, one of the factors here that should not be neglected is that the data that we have gotten from the Home Mortgage Disclosure Act, thanks to my former colleague Joe Kennedy, who worked very hard sitting here and helped get that through—thanks to that, we now know that the chances of your being put into a subprime loan, everything else being equal, are greater if you are African American or Latino, a condition that this country should not tolerate. And that has exacerbated this.

And so we have this legislation. As we go forward, we are going to try to work together on subprime, but also on fair housing and to deal with the regulators because it is a problem and it is compounded by the element of discrimination.

So I do want to make clear we are very well aware of that. The latest data was discouraging. In the City of Boston, the data showed that middle income African Americans were more likely to be in a subprime mortgage than white people several classes lower in the income scale. And we haven't forgotten that aspect of it.

Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman.

Mr. Shelton, I wanted to ask your view of the performance of Fannie and Freddie in their role in the secondary market, Fannie Mae and Freddie Mac, and their business function. What is your perspective of their role in the market in facilitating homeownership, especially in relation to lower income first-time home buyers? Have they been a positive?

Mr. SHELTON. From my perspective?

Mr. BAKER. Yes.

Mr. SHELTON. They have basically been quite positive. The problem has been that they have not been actively engaged in helping to make sure that we are protecting consumers along the way. They are there, and they are able to provide greater market, greater resources to be able to allow poor and moderate income Americans to be able to live out the American dream by owning their own homes.

If the question is, can they do more, the answer is, very clearly, yes, they can and yes, they should.

Mr. BAKER. My point was or that I was attempting to make was that this is a business enterprise that operates for a profit that facilitates homeownership and has a cafeteria style of products that they have innovated and offer that enables people who otherwise might not qualify for a loan from a portfolio lender, who is going to keep that asset in its own bank walls—you are able to sell it off to Fannie and Freddie as long as it meets certain criteria that they must approve. In fact, they actually have little boxes that they send out to the originators, and if you are the guy taking the application, you stick the numbers in and it cranks out a result.

That process is obviously blind to the nature of the applicant. It comes back with statistics on a piece of paper that go in and come back. That process, I take it, has worked fairly. Would you agree with that?

Mr. SHELTON. You are saying has it worked fairly well?

Mr. BAKER. Fairly well? Fairly? Pretty good?

Mr. SHELTON. It has worked fairly well. We have had meetings with Freddie Mac and Fannie Mae to talk about other ways we can expand their ability to do a better job of protecting consumers as they are going to purchase those mortgages. So if the question is, can they do more, the answer is yes. If the question is, are they providing a valuable service, the answer is yes. If the question is, will this bill help along in that process, the answer is yes there as well.

Mr. BAKER. I didn't get to that question yet, but I will in a minute. I have also had meetings with Fannie and Freddie and discussed ways that they could improve their business, too.

I would also point out that when you look at the elements that Fannie uses to determine if borrower "X" should be entitled to an extension of credit, one element of that calculation is the debt-to-income ratio. It is 65 percent. The bill has a 50 percent cap.

Now, there is no clear definition of what constitutes debt, so that is a little bit in the air right now. My point to you—and let me give you my little diatribe. No one on this committee I am aware of has ever expressed defense of those who abuse their fiduciary duties. In fact, we all are joined together to ferret out those who have abused their privilege—in my case, I have been sort of suggesting to Fannie and Freddie a change in their ways—and we will go after with vigor those who abuse this responsibility.

There can be, however, reasonable differences between people as to how we should accomplish this reform. I merely point out the DTI issue as one of several steps. The consequence of this, although some will argue to the contrary, I do not believe can be argued.

If your debt-to-income ratio is going to be capped or else you are outside safe harbor, consequently secondary market interests are going to be concerned about acquisition, and under the Fannie black box method you would qualify at 61 percent, there will be people who will be prohibited from entering into a homeownership opportunity that would otherwise be found to be an appropriate contractual obligation that might lead that family to live in that home for many years to come.

I just don't understand why we can't discuss the regulatory environment with an eye toward market operation and toward consumer protection. The two are not mutually exclusive. Is it your view that every originator of mortgages has violated their responsibilities to borrowers? Is it most? Is it some? Is it a small percentage? In my view, it is a small percentage, and we ought to go get them, and I will hold hands with anybody to go do it.

But we cannot ignore the consequence of policy which will ultimately restrict the flow of credit to people who otherwise would qualify, given the role of Fannie and Freddie in the marketplace. Do you agree with what I have just said?

Mr. SHELTON. Some of it. Let me just say that first, the idea here is to make sure that those who are able to take out loans for mortgages can sustain those loans, that they very well will not end up losing their homes, their life savings, and their futures in many cases.

Very clearly, under today's circumstances, we are very clear that the standards are not clearly in place. We are seeing now millions of Americans actually jeopardizing the very American dream that we all work so hard here in Washington to be able to secure.

Mr. BAKER. Well, let me point out that the investor market is also tied in parallel with that—

Mr. SHELTON. I understand there is legislation—

Mr. BAKER. If I may, sir, I will tell you that the investor end of the world is also tied because they are losing zillions. Every time homes go into foreclosure, it is not the way to make money. And nobody is interested in seeing failure. And so I suggest to you we are seeing this similarly.

Mr. SHELTON. Well, we are seeing this similarly. Perhaps the response in how we move from where we are now to a better situation for those who are about to lose their homes, and as we prepare for those who would like to be able to enter the market to experience the American dream by being able to own their own homes, is what this discussion is really all about to a great extent.

This legislation that we are talking about is legislation that we very strongly believe will move us a long way in helping to achieve that process of making sure we can protect Americans from these unscrupulous predatory lenders.

Mr. BAKER. So my time is—you have expired my time.

Mr. SHELTON. Sorry about that.

Mr. BAKER. But let me wrap up. So you don't find limiting the current Fannie/Freddie practices in their screening requirements and making them ratchet back ill-advised in consequence of this reform effort?

Mr. SHELTON. Freddie Mac and Fannie Mae have a major role to play in this process. I am not as secure in the terminology you utilize as being consistent with our vision and our view of these problems. But we would be delighted to sit down and talk to you about it.

The CHAIRMAN. And if the gentleman would allow me briefly, it is refreshing to have him come to the defense of Fannie and Freddie's practices in this—

Mr. SHELTON. We are all plowing new ground.

The CHAIRMAN. And fertilizing it.

[Laughter]

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

Mr. Calhoun, you have been here before, and this committee and the Congress of the United States have benefitted from the work that you have done. You have been one of the leaders in dealing with predatory lending. And I want you to help me to understand the yield/spread premiums a bit better.

As you know, this bill would ban the yield/suspend premiums. And I want to know whether or not some of our financial institutions and banks have encouraged loan origination from nonprofits and other groups who are benefitting also from the yield/spread premiums. Do you know how it all works?

Mr. CALHOUN. Well, the yield/spread premiums, I think, in the provision here is one of the most important because I think the approach of this bill that is really critical is not that it just prohibits the end results that we don't like, such as steering, but it addresses the market incentives that have produced those bad results. And the yield/spread premium has been at the core of that, along with prepayment penalties on subprime loans.

I think you heard support from even many of the regulators here because lenders are in a position where they can't correct that problem. If they adopt a policy—for example, Option One, one of the largest subprime lenders, previously had a policy of not paying yield/spread premiums. It even had on their Web site a disclosure to borrowers saying, don't get a loan with a yield/spread premium. It creates a conflict of interest.

They found that the brokers simply boycotted them and took the loans to other lenders that did pay yield/spread premium. And the result was not that borrowers were protected; Option One was forced to reverse its policy and start paying the yield/spread premiums like everyone else.

So that provision is one of the—

Ms. WATERS. Aside from brokers, who else was benefitting from the yield/spread premiums? Did nonprofits—were they able to originate loans and take advantage of earning money that way?

Mr. CALHOUN. That has generally not been a widespread problem in the market that we have seen, and we work with a large number of other nonprofits.

Ms. WATERS. The financial institutions that benefitted from having the brokers and others who were out originating loans, were these some of the ones that were getting credit for—getting CRA credit?

Mr. CALHOUN. There has been a problem that CRA credit and GSE, Fannie and Freddie, affordable housing credit has in the past at times been given for loans that were not constructive, that were predatory. And Freddie earlier this year, after we met with them, agreed to change practices to that, and Fannie has now changed it because OFHEO closed an area there. And so we applaud that move.

One thing that was raised earlier is we need to make sure that CRA credit and Fannie and Freddie affordable housing goals are used as one of the tools for rescue loans. And for those loans to get borrowers out of these exploding 2/28s, those should be given the highest credit to both the financial institutions who need CRA credit and also to Fannie and Freddie.

Ms. WATERS. Thank you. Mr. Taylor, you are from California, and we have a big problem.

Mr. TAYLOR. I am not from California.

Ms. WATERS. You are not from California?

Mr. TAYLOR. No.

Ms. WATERS. Oh, I thought you were.

Mr. TAYLOR. I get around a lot, but—

Ms. WATERS. Okay. Let me ask you, because you have been on the Hill working on the issue of trying to expand opportunities for low- and moderate-income housing for a long time, what would you do to strengthen this bill? This seems like a pretty strong bill, a pretty good bill. What else would you do?

Mr. TAYLOR. Well, I think that one of the most important things is how to deal with the securitizes because we all know that the pipeline that was built from Wall Street that essentially opened up the spigot for this kind of predatory capital and predatory loans, if there isn't accountability on that end, I think, you know, we are simply not going to deal with one of the major sources of the problem.

And so having accountability on that end, and having consumers have the right to be able to pursue remedies that really discourage this kind of activity. What we don't want to occur is the remedies end up being almost like a cost of doing business.

Now, I am not suggesting that the language can't be strengthened or we can't do some things that change things in this bill. But I am fearful that the way it is currently written, it is very difficult for people to hold people accountable, and it is very—on the broker end of things, being fined three times your broker's fee, you know, if you are only caught occasionally and you are willing to pay that fee, it may be just a cost of doing business.

On the securitizer's side, if you are really insulated because you get to sort of determine if you have done due diligence, and you have this fairly simple—what we think is a simple process to sort of certify that you are in compliance, we don't think that you are going to have the impact on that body that you need to have because they are critical, critical player in this whole process.

Ms. WATERS. Thank you.

Mr. TAYLOR. I don't know if one of my colleagues want to add to that answer.

Mr. WATT. [presiding] The gentlelady's time has expired. I now recognize the ranking member of the full committee for 5 minutes.

Mr. BACHUS. I appreciate that, Congressman Watt.

Mike Calhoun, I am going to ask you this question. Okay? You know the Paulson & Company, the hedge fund, the $20 billion hedge fund?

Mr. CALHOUN. Yes.

Mr. BACHUS. You are familiar with them?

Mr. CALHOUN. Yes.

Mr. BACHUS. You know what their investment strategy is?

Mr. CALHOUN. We asked earlier, did anyone see this crisis coming. They were one of the people who did, and they purchased stock options that were based on their projection that the subprime market would perform poorly.

Mr. BACHUS. Yes. You know, they profit from the carnage in the mortgage—you know, the meltdown in our mortgage market. I mean, you are aware of that. Right?

Mr. CALHOUN. The money that they made came from investors who took the opposite side of that projection and who were investing thinking that the subprime market would go up. So it was a transfer from some stock speculators who were betting the market would go up to those who were betting it would go down. Yes.

Mr. BACHUS. And yes, I mean, they have said—and people have characterized that. I know the American banker, that they were basically betting against the American homeowner, and that the more people that lose their homes, the more profit they make. I mean, absolute—the more foreclosures, the better off they are. I mean, that is true, isn't it?

Mr. CALHOUN. The more that subprime lenders' stocks go down, that is what they have bet on and that is what determines their profitability.

Mr. BACHUS. But there is a correlation between the number of foreclosures and—

Mr. CALHOUN. Certainly.

Mr. BACHUS. You know, knowing that, and it was all in the papers that they gave you all, what, a $15 million donation?

Mr. CALHOUN. Yes.

Mr. BACHUS. How do they—how does that square up? I mean, I am trying to visualize in my mind. You know, they profit from the foreclosures and the carnage in the mortgage market. And as things get worse, their profit goes up. But then they turn around and then give $15 million to CRL. Is that like their conscience is bothering them? What is that all about? How do they see you all as an advantage to them?

Mr. CALHOUN. Well, from our perspective, the $15 million is provided for foreclosure relief, to provide attorneys—most of this money will be granted by CRL to legal aid attorneys and other attorneys who represent borrowers who are facing foreclosure.

Mr. BACHUS. Yes.

Mr. CALHOUN. And there is—and I think this is an important point in the larger context of the bill—

Mr. BACHUS. Yes. Let me say this. I am not—you know, you take their money and you do something which is constructive, and you help people in foreclosure. I am not criticizing you. You know, I am not criticizing what you do. I am not criticizing your mission of protecting homeowners, trying to help them in a foreclosure situation. I am not questioning your motives or your mission.

I am just sort of saying—I mean, these guys are driven by the bottom line. I mean, they are hard-nosed businessmen. You know, been talking about hedge funds and all, and here is a hedge fund that kind of bet against—I mean, profits from the misery in the American housing market right now.

And I just—I am trying to figure out, did they tell you why they were giving you all the donation? I mean, did they say that they are profiting from this so they want to give the money back, or what?

Mr. CALHOUN. I think they recognized that a lot of families are losing their home, and wanted to make some effort to do something about it. And I think the message in the larger context here is, as we talk about the risk of litigation, is we have had a lot of bad lending going on and market crashing.

There has not been a wave of litigation. In fact, it has actually been the opposite. There has been a dearth of lawyers to represent borrowers who are facing foreclosure even when they had very illegal loans. And that is our concern, that this bill—if you put it in the context of the bill that is before the committee and your bill today, too—is we fear that you go too far in insulating the secondary market. We believe it needs to be preserved. It is absolutely critical and has to be preserved.

But if you totally insulate it, you make it even harder than it is today for borrowers to get relief, even in foreclosure.

Mr. BACHUS. Okay. I guess all of a sudden I am realizing what—so the increased litigation against these subprime companies or, you know, mortgage companies obviously takes money off their bottom—you know, their balance sheets and their bottom line. And I guess it helps drive that stock down, which Paulson & Company would profit from.

Mr. CALHOUN. In most cases now, the loan is owned and the credit risk has been passed on to the secondary market.

Mr. BACHUS. When the secondary market melts down, do they profit financially? I guess they would, wouldn't they?

Mr. CALHOUN. It depends. Typically, the subprime lender is insulated at that point.

Mr. BACHUS. All right. Thank you.

Mr. WATT. The gentleman's time is expired. I will now recognize myself for 5 minutes. Before Mr. Baker walks out, I will say something nice about him.

Mr. BAKER. I am not going anywhere.

Mr. WATT. That will make him sit down. The one thing I have found about Mr. Baker is when he says something, I don't always agree with it, but it does cause me to look at provisions much, much more carefully than I otherwise might. And his questions about the debt/equity ratio is one that, before he left, wanted to make further inquiry.

In the bill, there is this final product. It is on page 58 of the bill. It says, "A creditor may not extend credit to a consumer under a high cost mortgage unless a reasonable creditor would believe at the time the loan is closed that the consumer or consumers will be able to make the scheduled payments associated with the loan." That is the general statement. And then it creates a presumption of ability to pay if the debt-to-equity ratio is 50 percent or less.

Now, if you read that the way it is written, the presumption is independent of the general rule. But as a practical matter, I guess the question I am raising and the question that Mr. Baker is raising is: Will the 50 percent debt-to-equity ratio become the standard as opposed to just creating a presumption? And therefore, if somebody is creditworthy even though they have a debt-to-equity ratio higher than 50 percent, will that make it impossible for them to get a loan?

And so I would just invite you all at some point to look more closely—I don't expect you to do it on the fly today—at whether it might be more advantageous, as Mr. Baker—I think his suggestion—

Mr. BAKER. Would the gentleman yield?

Mr. WATT. —to end the discussion at the end of line 12, where we state the general rule and don't put the presumption in there. I am happy to yield to the gentleman. I didn't want to dwell on this, but—

Mr. BAKER. No, no. I appreciate the gentleman's courtesy, and I will be very brief. First, I want to acknowledge the chairman's mark does allow regulators to go beyond the 50 percent limitation that is the presumptive statement of the gentleman.

But secondly, there—

Mr. WATT. But if it is a counterproductive—if the market is going to read that as if anything that is not fitting in that presumption is therefore unallowed—

Mr. BAKER. I think the gentleman's perspective is correct. It will create—if you are worried about reputational risk as a mortgage originator as the securitizer, you are going to look at the statute as evidence of what constitutes expected practice, and you will have to explain yourself.

And one other little quick point and I will quit. The DTI ratio is not only a problem for low-income borrowers, who generally may have a higher debt load; it is also a significant problem in high cost mortgage areas like New York, where you typically have someone who has much more than 50 percent of income in mortgage payment. And then finally, the debt itself is not defined.

Mr. WATT. I understood that when you made your original point. We don't want to unintentionally create a consequence that we are not looking for. So I would just ask you all to look at that time a little bit more aggressively. I will look at it more aggressively also, and ask the staff to look at it.

The other question that was raised in both Mr. Calhoun and Ms. Bowdler's testimony was this question of enforcement. And I have been trying to glean my way through this because what you all seemed to be saying was that somehow, the anti-steering provision would have a lower level of enforcement than other Truth in Lending enforcement provisions.

I don't see that. It may be true; I am not suggesting that it is not true. But if I trace—the anti-steering provision becomes a part of the Truth in Lending Act. Then we say on page 19 that there is enforcement of the Truth in Lending Act. And then we go back at some point and make it clear—I may have lost my place where we do that, but at some point we make it clear that nothing anywhere in the bill reduces the rights that people have under the Truth in Lending Act.

So maybe I am missing something here. And if you can enlighten me now, do so. If you can't do it right now, I would invite you to do it as we move forward in this process.

Mr. CALHOUN. In two respects, the liability for steering is greatly restricted. First of all, on page 20, line 4, there is a cap for violations of Title 1 of 3 times the originator's fee. And this was addressed, I believe, in other testimony, to any of the violations of Title 1. And that is where the steering prohibition appears.

And so that would be a cap which typically would be far below the typical Truth in Lending damages. And if you have, for example—you know, it has been talked about if there was a loan with a broker fee of $2,000 or $3,000, 3 times that would be the maximum cap even though the steering violation could have caused much larger actual damages.

Equally important, there is no secondary market liability for violations of Title 1, which would include the steering violation. So you would have no action against the secondary market if you have been steered to a more expensive loan.

Mr. WATT. I like sitting in the chair because the lights don't work to cut me off. But I am going to presume, as we do in that section that we were talking about on page 58, I am going to create a presumption that my time has expired. And therefore—

The CHAIRMAN. You managed to fake out the clock when you yielded to Mr. Baker, and they thought that you had given up your time. So that worked very well.

Mr. WATT. My time is expired, and I recognize Mr. McHenry for 5 minutes.

Mr. MCHENRY. I thank my colleague for yielding.

Mr. Calhoun, I wanted to follow up on the ranking member's questions. Paulson & Company is a hedge fund that is betting on the mortgage crisis getting worse. Correct?

Mr. CALHOUN. They are betting on subprime loan company stocks declining.

Mr. MCHENRY. As you said, the more subprime company stock goes down, the better they do, and apparently the better CRL does because you got a $15 million contribution from them.

My question to you is this. There is also the Brad Miller bankruptcy bill. Reading from Business Week, you have been invited—the Center for Responsible Lending has been invited by Secretary Paulson to get in and advocate for this bankruptcy bill, which many regard as having the effect of chilling the marketplace even more and harming subprime company stocks and the mortgage market. Is that correct? Have you joined the coalition?

Mr. CALHOUN. We have not made a decision whether to join the coalition. We were one of the—we have advocated for bankruptcy reform narrowly targeted to this crisis for a long time.

Mr. McHENRY. All right. Well, it seems—it is apparent that your funders are also interested in you helping propagate a crisis so they can profit.

Let me talk about the North Carolina law because a lot has been made of this North Carolina law, and I know you have touted it significantly. A number of different studies have come out, and I know you have seen some of them. But I also know that CRL is in the mortgage lending business. From your disclosure with the NCUA, you had a 191 percent jump in delinquent mortgages between 2004 and 2005.

Is this predatory lending?

Mr. CALHOUN. Our mortgages are fixed rate mortgages, typically within 100 to 150 basis points of prime loans. We make them in connection with major bank partners, including most of the top 10 banks in the country.

Mr. McHENRY. So you had a 191 percent increase in 12 month and over delinquent payments. How do you explain this? I mean, apparently you have issues in the mortgage marketplace as well.

Mr. CALHOUN. We have enjoyed a foreclosure and loss rate in the low single digits. An experience that we have and other mortgage lenders have in the subprime market is that these loans do have greater delinquency. Overall—

Mr. McHENRY. So you had a 191 percent jump, and that is acceptable?

Mr. CALHOUN. Provided—we monitor our loans very closely—provided that those loans cure and catch up. And that has been our experience when—

Mr. McHENRY. And you have had significant write-downs as well. In 2006, you had a 163 percent jump in chargeoffs and a 220 percent increase compared to 2005. That is significant.

Mr. CALHOUN. The percentage increases are, but our chargeoffs are still far, far below industry standard.

Mr. McHENRY. Well, I will accept that. That is fine. But let's talk about the overall issue in North Carolina—

Mr. TAYLOR. Can I ask—

Mr. McHENRY. —because the North Carolina law—I can get to you. I only have 5 minutes, sir. But there is a decline, an 11.4 percent decline, in subprime refinancing in North Carolina after the North Carolina law went into effect, compared to a 4 percent increase in other States.

As I see it, as I see it, we have an issue right now of people who are trying to refinance out of these high rate loans, high cost loans. If we put in place the North Carolina law at the national level, which is part of the legislation we are discussing today, that will further constrict people's ability to get another loan and refinance.

If you look at the North Carolina experience, it is an 11.4 drop while at the same time other States experience a 4 percent rise. It seems to me that what you are advocating is exactly what the folks from Paulson & Company in the hedge funds want, which is to further spread the pain of these losses in the mortgage market and make it more difficult for people to get lending to get out of the troubles they are in.

What do you say to that?

Mr. CALHOUN. North Carolina, like other States, saw an explosive boom in subprime lending, including refinancing, since the North Carolina law has been in effect.

Mr. MCHENRY. That is not true.

Mr. CALHOUN. Our lending—refinancing—

Mr. MCHENRY. What are your facts? What is your proof on that?

Mr. CALHOUN. I will be happy to submit to you from industry sources the exact volumes—

Mr. MCHENRY. Because I have three different studies here.

Mr. CALHOUN. It quadrupled our subprime lending—

Mr. MCHENRY. Burnett, Finkel, and Kaul in 2004 confirmed this notion, finding a 16 percent decline in origination by subprime lenders in North Carolina. That is a significant difference.

Mr. CALHOUN. Subprime lenders or subprime loans?

Mr. MCHENRY. Subprime lending.

Mr. TAYLOR. There was one study—

Mr. MCHENRY. And I am speaking to Mr. Calhoun, sir.

Mr. CALHOUN. I don't know which one you are quoting from there, that showed—

Mr. MCHENRY. Burnett, Finkel, and Kaul.

Mr. CALHOUN. —that showed a reduction between the time the act was enacted but before it went into effect. But subprime lending, and the Commissioner of Banks has been here and testified several times to this in North Carolina, has grown explosively, which is a good thing and which we encourage. We are subprime lenders and view that as an important ladder to the middle class.

Mr. MCHENRY. But just for note—

Mr. CALHOUN. But it has been a trap door with the abusive loans that we have had.

Mr. MCHENRY. But just for note, there is a—the growth rate in subprime lending in North Carolina is 20 percent less than the national growth rate. So it has been further restricted.

My concern here is that we don't hurt the very people that all of you espouse to help and we all seek to help, those that are in very difficult financial situations. And I believe if we put in a government mandate of what mortgages are allowed and not allowed, and specify key loan terms that the market can only accept or reject, that we are going to hurt the very people we are seeking to help to get out of this mortgage challenge that we are facing.

So with that, I would be happy to yield back my time.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLEAVER. Mr. Chairman, in the interests of time and, since I agree with and in most cases identify myself with the comments of the panelists, I would forgo any questions. I appreciate the statements from our panelists and I would hold my comments to the next panel. Thank you.

The CHAIRMAN. I thank the gentleman. Mr. Taylor, do you wish to respond?

Mr. TAYLOR. I am very upset about this last line of questioning. Because I didn't realize this was a hearing on CRL which, coincidentally, does primarily lending to low-income people, which might have something to do with why they have high delinquencies. And it is delinquencies, it is not defaults.

I mean, their record of serving underserved people is impeccable and second to none. And the inference, which I see as just bullying, that because you receive a contribution to do something good—I mean, all of you up there get contributions from many of the people that we are talking about. I find it deplorable that you would attack the integrity of that organization.

Mr. MCHENRY. If I may respond, Mr. Chairman?

The CHAIRMAN. Let him finish and then, it is not your time, but the gentleman's time, but if he finishes, I will call on you.

Mr. TAYLOR. I just think that it is unfair to look at a source of income. I think you need to look at what their contribution has done, what they have been trying to do. And clearly, for many years, they have done loans to people who are underserved. They have been a leader in fighting to try to assist the people that you say we are all trying to help, and that is underserved people. None of us are trying to constrict the market. The only thing we are trying to constrict is bad loans that get people into trouble.

And I just find your line of comment offensive. And I don't mean any disrespect for that. I am just sitting here offended on behalf of CRL because I don't think it is fair.

Mr. BACHUS. Mr. Chairman?

The CHAIRMAN. Yes, the gentleman from Alabama.

Mr. BACHUS. If I may respond, I would like both—since we have gone extra time, I would like—are you talking about the gentleman from North Carolina? Are you talking about both of us?

Mr. TAYLOR. I wasn't referring to you, Mr. Bachus. That particularly was bothering me.

Mr. BACHUS. And let me just say this, because I thought you—

The CHAIRMAN. I was going to recognize the gentleman from North Carolina. If the gentleman from Alabama wants me to recognize—

Mr. TAYLOR. I thought you said—your comments were not designed—

Mr. WATT. Mr. Chairman, point of order?

The CHAIRMAN. Yes.

Mr. WATT. I am just wondering, it seems to me we are wondering, Mr. McHenry has had his say, Mr. Taylor has had his say. This is not about CRL; this is about the bill. And I would—

The CHAIRMAN. I appreciate it. I will give Mr. McHenry a brief time to respond. He did have his time and Mr. Cleaver's time. But I will recognize Mr. McHenry.

Mr. MCHENRY. I appreciate it, Mr. Chairman. And I want you to know very sincerely, Mr. Taylor, I know you wanted to answer some of my questions. But my questioning—I am from North Carolina. I served in the legislature. I have a large awareness of CRL.

I know that their studies are vastly different, in many cases, from the rest of the industry and the rest of the marketplace. I am not questioning Mr. Calhoun's integrity, never did I do that. I am offended that you would say that.

But let me finish by saying this. I think all of you are respectable human beings for coming forward and sitting before this committee and taking tough questions. This is a real issue for America. I am very concerned about it and all my colleagues are. It is out of genuine concern that we want to make sure we do this correctly and that we don't hurt the marketplace.

The CHAIRMAN. Mr. Cleaver, did you—

Mr. CLEAVER. I just wanted to say, I will never pass again.

[Laughter]

The CHAIRMAN. No good deed goes unpunished, Pastor. You should have known that.

Next, the gentlewoman from Florida.

Ms. BROWN-WAITE. Thank you. And I apologize for not being here this morning. I am the ranking member on Veterans Oversight and that is why—

The CHAIRMAN. I would say to the gentlewoman, and I would say this in general, as chairman, I have come to the view that no member need apologize to me for not being here. Sometimes, I wish some members would apologize for being here.

[Laughter]

The CHAIRMAN. But I never object when members are not here.

Ms. BROWN-WAITE. Thank you, Mr. Chairman, for being so understanding. I hope I am not one of those members you would rather not have here.

When I have spoken to constituents who have contacted me about problems that they have incurred about having a subprime mortgage, it was a combination of issues that they faced. They didn't realize or they realized it and just the combination of events became overwhelming. But when you buy a piece of property, that that property gets reassessed at the sale price, the higher price.

I happen to be from Florida where homeowners insurance is overwhelming. And now to add insult to injury, we also are redoing the flood maps so people who, when they bought the home weren't in a flood area, they now have to buy flood insurance. So it is not just the subprime issue that is causing so many foreclosures.

I would like to have anyone on the panel comment about that. It certainly is a part of the equation, but I don't think that it necessarily is the whole equation. And I know that insurance rates in North Carolina, for example, have gone up. Anywhere along the coast they have gone up. And last time I checked, most places reassess the value of a property at or shortly after the property is sold. So are we looking at the whole shebang here or are we just saying it is the subprime that has caused the foreclosure?

And any one of you on the panel who would care to answer.

Ms. BOWDLER. Sure. Can you hear me? I will go ahead and jump in and start but my colleagues, please feel free to jump in.

I think the point you raise is a really excellent one in that so much of the dialogue about this bill and about the problems in the market have been very global. You know, what is going to go on with Wall Street, what are the investors going to do? But really, there is also a very transactional nature to this business and I think actually it was Mr. Barrett who said it in his opening statement, relationships are important.

And so what we have seen is those folks on the ground who are doing the appraisals and the mortgage brokers who are actually arranging the transactions, they carry a lot of weight. Families trust them the same way they trust their doctor or lawyer. So certainly, it is NCLR's position that unaffordable loans, which have really festered in the subprime market to a large extent are really at the core of the predatory lending problem that we have. But the additional problems that you are describing really go to ability to repay and whether or not that originator that was sitting across from that family took into account the actual taxes and insurance that that borrower was going to have to repay, and did they account for things like in Florida where situations may change?

And certainly we believe that they have a responsibility to do that. They are an advisor to the borrower.

Ms. BROWN-WAITE. Well, at closing, there have to be certain forms that are filled out, the RESPA form if it went through a real estate agent, etc., so that that information is out there, and they have to do it to the best of their knowledge.

Now, rates in Florida, assessment rates, are determined in late September for the taxing year. And you can only guess what a county commission is going to do, because sometimes it really is a guessing game. But they are required to give that information.

Is it that people get so caught up in the oh, good, I finally can buy a home, that this euphoria takes over and the day of reckoning is kind of put off in the back here? Regardless of whether it is a subprime or not. Which I have a follow-up question. I don't know how much more time I have.

But what basis would a lender actually have for determining which loan is best for a consumer?

Mr. BRYANT. Before your follow-up question, the issue there is financial literacy. I mean, the same issue—my dad is a brilliant guy, a great businessman. But he didn't understand money. And so if you don't know better, you can't do better.

If you are signing documents that you don't understand, if you are asking what the payment is versus what the interest rate is—and this is not a poor people issue; 80 percent of Americans, according to the Federal Reserve, are living from paycheck to paycheck.

Financial illiteracy is a universal issue and that has to be addressed. Otherwise, you are just rearranging the deck chairs on the Titanic. So that is number one.

Living by the coast—

Ms. BROWN-WAITE. But, sir, those figures are in front of you at a closing. Those figures are in front of you at a closing to the best of the person's—

Mr. BRYANT. But if you don't understand money, if you don't—it is what you don't know that you don't know that is killing you.

If you are financially literate, it is hard to understand somebody who is financially illiterate. But the issue is here that if you do a survey of your staff, you will find that they are living from paycheck. This crisis—

Ms. BROWN-WAITE. Did they complain to you?

Mr. BRYANT. Excuse me? I will check my e-mail.

Ms. BOWDLER. The fact that the documents and disclosures are present at closing is really—is one part of the problem that was brought up earlier about the timeliness of the information. By the time you sit down at the closing table, your bags are packed, your earnest money is in. All of that is going on. Everything you sign at that point is to protect everybody else; nothing about it is actually to protect the borrower or really to even inform the borrower.

It is like putting in front of you the manual for how to conduct your own surgery and then saying, why didn't you know how to do your surgery?

Ms. BROWN-WAITE. Ma'am, let me just tell you, I have had Realtor after Realtor tell me about people who go to the closing table and they say, whoa, didn't know my homeowners insurance was going to be that much, I didn't know my payment was going to be this much.

They walk away at the closing table because they are informed and they are told how much it is going to be. So I am—

Mr. TAYLOR. If I could respond to that?

The CHAIRMAN. Quickly.

Mr. TAYLOR. We actually deal with a lot of consumers who find themselves in these problems. And invariably we hear a very similar story of people going in and thinking that the—whether it is the broker or the lender, are really operating in their interests. And basically there is a lot of kind of blind faith in the process in which they think those people are operating in their interests. And a lot of people are kind of talked into, you know, you can do this loan, it is not going to be a problem, don't worry about it, this is the way everybody is doing it. And they really believe these folks.

And in Florida, the other major problem you have is you have massive amounts of appraisal fraud and valuations that are very inaccurate that I think are compounding, which gets at the first part of your question.

The CHAIRMAN. I think we are going to be dealing with the appraisal issue, in fact, in Mr. Kanjorski's appraisal and other places.

The gentlewoman from New York.

Mrs. MALONEY. Thank you. I would like to ask the panelists, beginning with Mr. Calhoun, to respond to this statement that I hear often from industry representatives. And some industry representatives claim that any effort to regulate these mortgage products would result in an even greater credit crunch, making it difficult for people who should have a home and should be able to afford one, that the credit crunch will hurt them. So I would like you to respond to that claim, Mr. Calhoun, Ms. Bowdler and just down the line, anyone.

Mr. CALHOUN. First, let me say I agree that we need to be extremely careful not to restrict credit. And the bill does this in one fundamental way, in that it allows very high interest rates. You can charge interest rates, for example, before you even trigger the high-cost loan threshold, you can be charging 13 percent interest on a first mortgage loan.

Now that is why Joe Smith, the commissioner of banks, comes in and says there are not many people being denied credit when you can charge them 13 percent on a first mortgage loan. But we think that is appropriate because the market works well competing over interest rates.

What the bill we think appropriately does is eliminate some of the gimmicks, for example, locking borrowers in with prepayment penalties so another lender can't come in and refinance them at a much better rate. But we need to be very careful not to restrict credit, that we allow it but channel it toward the interest rate where competition—and again, it has to be competition and self-policing that makes this work. We can't look over the shoulder on three million subprime mortgages a year, much less the 15 million total mortgages being originated each year.

Mrs. MALONEY. Would anyone else like to comment?

Ms. BOWDLER. We agree. And it is really not about cutting off credit to the subprime market because we agree that it is important and I think there is a viable market out there that is demanding to be served. It is about fair and equal access to credit.

We actually went out and talked to mortgage brokers and interviewed them and we found that they were doing responsible business in this area and they were earning a profit. They were making a living. It can be done. You can offer fair and safe products in this area and make a living. And it sounds like the Congresswoman from Florida had access to those kinds of agents that said to their borrowers, this isn't for you, and that is what you should be doing.

Mrs. MALONEY. Any other comments?

Mr. TAYLOR. We have a serious credit constriction now and we don't have this law. We have it because we didn't have this law. We have the problem because there just wasn't standards and accountability that would allow for clean and fair lending processes. So we have it. We have this constriction because we—and, frankly, I don't know who the folks are who are saying we are going to have a credit crunch if we have this bill. But we sent a bill in last week to the Chairman, both this committee and the Senate Banking committee, signed by NCRC and the top 10 banks in the United States calling for national anti-predatory lending legislation. So I don't know who those folks are, but my suspicion is those are the ones who profit from these kind of predatory kind of loans that want to not have the law that prohibits that. But I can tell you, the mainstream financial institutions who got out of a lot of this business a long time ago, yes, sir.

Mrs. MALONEY. Thank you. I would like the panelists to comment on some of the statements—

The CHAIRMAN. You had one other—Mr. Bryant wanted to comment.

Mrs. MALONEY. Excuse me.

Mr. BRYANT. Just building on that, with mortgage brokers alone, you have the wild, wild west out there right now. There are no rules of engagement. This provides rules of engagement. It also provides a floor, not a ceiling. It's very important, and I think it will create an environment where more capital gets unleashed because people know the rules of engagement.

Right now there is a credit crunch, right now. So this will hopefully free it up by providing clarity.

Mrs. MALONEY. I would like the panelists to comment on really the statements by Sheila Bair from the FDIC, which called for having mass negotiations to help people stay in their homes. And the fact that we have done so much on this committee to help people stay in their homes, yet the percentage of people who are negotiating and taking advantage of these tools is only 1 percent.

What can we do? Fundamentally, this bill moves forward to prevent it, but what can we do to help these people stay in their homes? Why is it 1 percent, such a low number, and what about her idea of mass negotiations?

Starting with Mr. Calhoun and down.

Mr. CALHOUN. Congresswoman, there has been a lot of work including by members of this committee and organizations represented here, to try and untie this Gordian knot of how do we make the modifications. And we have knocked down a lot of the obstacles.

At first, there were the pooling and servicing agreements and then tax rules. But there are two huge obstacles that remain and are blocking modifications and no one has figured out how to get around them. And they are the following.

First, the effect of a foreclosure on security holders depends not only on the amount of the loss but when it happens. And so if a foreclosure happens under the typical structure, if it happens in the first 3 years, it falls to the lowest tranches to pay it. But if it happens after that period, other tranches pay it.

And so it has been reported in the financial press that this is a major obstacle because the holders of the tranches, the securities who get the later foreclosure losses are telling the servicers if you modify this loan, and not all modifications will be successful, and move the foreclosure to my time period, I am going to sue you, because you have increased the risk of my security over the original structure.

The other huge obstacle, structural obstacle, that has and will continue to prevent modifications is that data shows that somewhere between 40 and 50 percent of these resetting loans have piggyback second loans. And that makes it extraordinarily difficult to modify the first. Because the first lienholder is basically going to say, I'm not going to take any reduction in my rights or payments until you wipe out the second. The second has no incentive, sometimes it is by another lender, usually is in another security.

That is what led CRL to conclude that there needs to be some limited relief in bankruptcy, to create a standard not to force people into bankruptcy but to create a legal standard of this is what modifications can be done and servicers, you won't get sued if you do them.

The CHAIRMAN. The time has expired.

The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

I guess following your lead, I will not apologize for having to miss a fair portion of the hearing due to other commitments. But I did understand, Mr. Taylor, that you lamented my absence and thought I had a fundamental misunderstanding of Adam Smith's philosophy, as I alluded to the economist and philosopher in my opening statement.

Although it has been a number of years ago, I have actually plowed through The Wealth of Nations in its 18th century English. I have a degree in economics, graduated with honors, served on the House Budget Committee, and serve on this committee. So, please, I want to give you your opportunity to illuminate for me what my fundamental misunderstanding of Adam Smith may be.

Mr. TAYLOR. I think the fundamental misunderstanding is whoever communicated what I said to you. Because actually I was agreeing with the use of Adam Smith in this conversation. And what I went on to say is I went deeper into Adam Smith's—the basis for his defining what makes for a healthy economy and I talked about capital accumulation, free trade, the role of government, and the rule of law.

And the things that I emphasized which you didn't talk about, it is no slight on you, you just weren't talking about it, but is the importance of making sure that the individuals' rights and properties are protected. And that was the thing. So I mean, you probably do know more about Adam Smith than I do. But from what I know, and frankly I am quoting Chairman Greenspan, so—

Mr. HENSARLING. Always a good one to quote.

Mr. TAYLOR. Exactly.

Mr. HENSARLING. Mr. Calhoun, I did miss your testimony although I see a portion of your written testimony.

On page 10 of your testimony, you say, "In short, improved disclosures are not likely to help borrowers." Why is it that if a—well, let me ask it this way. Is there just something fundamentally wrong with consumers? Are they just incapable of understanding financial transactions? Why is it that effective informed disclosure seems to be an impossibility in your mind?

Mr. CALHOUN. First of all, we strongly support improved disclosures. But it is not just our opinion, but the GAO studied the issue and concluded that improved disclosures were not likely to significantly reduce predatory lending. And the reason is that the market currently rewards unscrupulous practices and in fact penalizes lenders who engage in responsible practices.

Mr. HENSARLING. Well, let me ask you this question if I could. It continues to be an ongoing debate in this committee, and I have been on this committee for almost 5 years. I haven't exactly heard a consensus on the definition of predatory. But if there is effective competition within the marketplace, no barriers to entry, if I as a consumer, if I understand the financial transaction that I am undertaking and I am over 18 and I consent to that transaction, how is that a predatory loan?

Mr. CALHOUN. When borrowers are steered to loans at much higher interest rates than they qualify for, when borrowers are provided loans and given representations that this loan is appropriate for you when in fact they have no possible reasonable ability to repay the loan short of winning the lottery, and that is what we have seen, not just as the exception but widespread throughout the subprime market.

This is an unprecedented market meltdown in foreclosures. And it is not that borrowers suddenly became dumber in the last 5 years, or that divorce, the economy tanking, or anything else has driven it.

They were marketed very poor products and a lot of people made a ton of money doing it. The market said, if you put a borrower into a higher interest rate loan, I'll pay you more. If you tag on a big prepayment penalty, I will pay you more. If you make it a no-doc loan, I will pay more.

The head of one of the subprime lenders said, Wall Street was telling me, I will pay you more for no-doc loans. Well, what do you think I am going to send to Wall Street?

Mr. HENSARLING. Mr. Calhoun, does your organization believe that the individual borrower has any personal responsibility to ensure that he is entering into a financial transaction where he can afford to repay? Does your organization admit to the possibility of predatory borrowing?

Mr. CALHOUN. There has been fraud by borrowers in the market. Although, again, we believe, and I think the numbers support, that that is a small part of the problem.

We strongly believe that borrowers have responsibility. We enforce our loans, including in foreclosure, where we are unable to mitigate the loss or work out a modification. We don't believe that borrowers should be guaranteed the best loan. We don't believe that borrowers should be guaranteed a successful loan.

What we do believe is that the market should put in protections, have protections and fair rules. We have analogized it to this. It is the time of the year, if you had a football game and we said we are not going to prohibit holding, we are going to tell people maybe they shouldn't hold, but there is going to be no prohibition, no penalty if you hold, I think our football games would look a little different than they do now; everybody would be holding.

And that is essentially what we have here, a floor of reasonable regulation. And that is not an easy balance to strike. And we have acknowledged that and I think that is one reason it has taken this committee so hard looking for that balance. But a reasonable balance of regulation helps borrowers, lenders and investors.

Mr. HENSARLING. I see my time is over.

The CHAIRMAN. The gentleman from California.

I am going to ask the witnesses to try and be a little more concise.

Mr. SHERMAN. I thank the chairman for not applying that to the members.

One comment about the gentleman's comments from Texas. I mean, this meltdown did not come about just because we had bad loans. We had bad loans 3 years ago. It came about because we no longer have a rising market. And a rising market hides all the transgressions.

So you can have lots of bad loans, you have a rising market, things look okay. But when the market then levels off, the transgressions are exposed, the transgressions are exposed, the market then gets even worse and then you have the downturn.

The chairman in my last comments educated me about what is in the bill. And one thing we are concerned about is that ability to pay. Now, ability to pay includes ability to pay the property taxes. I hope that we specify in the bill that it is the ability to pay the property tax you expect to get after you buy the house, especially in those States like mine where, unless you are a senior citizen, the property is going for sure to be reassessed as soon as you buy it.

And so I hope that we are able to fine tune the language so that when we say ability to pay the property taxes, isn't the low bill, which in my State can be very low in the hands of the prior owner, but instead is the property taxes this consumer is going to face.

Now, one thing we have in the bill is a 50 percent debt payments to income ratio. That is to say in determining whether somebody can afford to pay, we say we look at their car payment, we look at their student loan payment, we look at all the payments they have on non-real estate debt, we add in the cost of property, principal, interest, taxes, and insurance for the home they're buying, and we look at that whole piece and we can make sure that it does not exceed 50 percent of their take-home pay.

Is 50 percent the right number? By a show of hands, how many think that in order to keep things affordable your total real estate payments plus your other debt payments need to be set at only 40 percent of your take-home pay?

The record should show no hands went up.

How many people think we should set that limit at 60 percent, so if somebody wants to commit 60 percent to their real estate payments and their other debt payments, that that is an acceptable, reasonable thing for a consumer to do?

Mr. TAYLOR. It depends on the terms and conditions. And—

Mr. SHERMAN. I am asking you to help us draft just one section of the bill. We got a safe harbor, we require a lot of things to be in that safe harbor. One of the things we require is some debt payments to income ratio. So assuming the rest of the bill stays the same, we are not going to let you write the whole bill, we are only going to let you write one number in the bill and that is that percentage.

Do you write it at 50, speaking on behalf of your organization? Knowing that if we set this number too high, we let people get in above their heads. If we set the number too low, we turn away from homeownership people who want to own a home. We got the number in this bill, say the exact bill just as introduced is going to pass. You may or may not like the bill. You only get to write one number. You want 50 percent, you want another number?

I see the witness to your left may have a comment?

Mr. BRYANT. You know, it is interesting, most of this bill deals with a floor, sort of a floor approach.

Mr. SHERMAN. Right, we don't want to write the Federal bill. In this bill—

Mr. BRYANT. This is the one aspect that deals with almost a ceiling approach. And the paragraph right above it actually deals with, basically says you can only write a mortgage the person can afford to pay. That may be a more sophisticated, a more reasonable approach to this.

I don't know what the right number is, but here is what I do know—

Mr. SHERMAN. Let me just—I have a limited amount of time. Do I have anybody here who has a right number, who believes that any particular number should be in the bill?

Ms. BOWDLER. I can tell you that for the 20,000 families who come through our counseling network, most of their affordable products that they get connected to, those—

Mr. SHERMAN. Excuse me. This is just one of my many questions. Does somebody have a percentage number other than 50 percent that they recommend to the committee.

Ms. BOWDLER. We are okay with 50 percent.

Mr. CALHOUN. Fifty percent, and I think it is key to remember that is 50 percent of their gross income before the taxes are out. So you are talking about—

Mr. SHERMAN. Oh, so you are at 50 percent not of take-home pay, but 50 percent of gross pay.

Mr. CALHOUN. And that is how that, I believe, is intended. And so it is a much—

Mr. SHERMAN. So the way I would—in my world, that is a 60 or 70 percent number.

Mr. CALHOUN. Exactly. So we think that is plenty high.

Mr. SHERMAN. That leaves you with very little take-home pay to devote to anything else. So you are for 50 percent if it is 50 percent of gross pay.

Mr. CALHOUN. That is how it is done in the industry. That is our understanding of the intent of this bill.

Mr. SHERMAN. Okay, let us move on to another percentage type question. Let us say we have stacks each containing 100 mortgage applications. We have a stack here where I could tell you statistically 25 percent are going to default and lose their homes. But the other 75 percent are going to be able to make it, going to be able to pay the loan. I have a crystal ball, I know what economic conditions are going to be; 25 percent default, 75 percent people are able to move into a home.

Should government come in and say, don't make any of those loans? Or should government allow the lender to make all 100 loans?

Mr. CALHOUN. We think the approach in this bill is right, is set fair standards, don't guarantee success. People get the opportunity—

Mr. SHERMAN. Okay. But I mean, we could set the standard differently. What I am trying to get at here is, obviously, if we could make 100 loans and only one was going to default, we would say, hey, that is great, 99 people became homeowners. There is always going to be 1 out of 100 that is a problem.

At the other extreme, we could say, hey, go make 100 loans. If 10 people get to stay in their house and 90 percent have to move back to an apartment, that is okay.

Where do you draw the line? What is—

Mr. TAYLOR. If the 25 percent is defaulting because of loss of job, then that is acceptable. If the 25 percent is defaulting because the originator put them in a loan they really couldn't afford in a short period of time, it is not acceptable.

Mr. SHERMAN. Okay.

Mr. TAYLOR. And that is what this bill addresses, ability to pay, duty of care.

Mr. SHERMAN. Okay, that is a fair answer. Anyone else have an answer? I yield back.

Mr. KANJORSKI. [presiding] Several of the witnesses have expressed support for my legislation, H.R. 3837, which Mr. Frank and I have agreed to mark up in the coming weeks. We need to fix problems related to escrows, appraisals, and mortgage servicing in order to develop a comprehensive solution to the complex problem of abusive and deceptive lending.

To help us establish a better record on the need to enact policy reforms in this area, I am hopeful that each of you can answer for us how some or all of the following questions are understood or relate to your specialties.

First, why is there a need for mandatory escrowing of taxes, insurance, and other periodic payments for consumers with high debt and bad credit?

Mr. CALHOUN. It is to set a fair rule for the marketplace to compete with. We hear complaints from this as much from lenders and brokers as we do from borrowers.

Brokers come and tell us that they can't escrow because if they do, they will get undercut by another broker who will come in and offer a loan without escrow that looks cheaper.

I mean, Fannie and Freddie require this for similar loans in the prime market. And we really want to commend both you in your bill and also the leadership that Mr. Bachus has shown with his bill and also some of the other provisions. We wrote a letter supporting those.

Mr. KANJORSKI. It sort of raises the question of financial literacy in a way. Is it so often that these buyers are unsophisticated and they do not anticipate the need and the value of escrowing, what it means, and anticipate the problem of not escrowing? Because I think the statistics show that about 60 percent of the regular securitized mortgages are escrowed, whereas only about 25 percent of the subprime are. And it sounds incredible, because I would think it would be the complete opposite. Here, the people who need the support system the most are getting it the least.

Mr. CALHOUN. Our experience, very quickly, has been that most borrowers have assumed that escrow was included, particularly when it was included in their previous loan. And if you will, the broker has come in and said, I can lower your payment by hundreds of dollars a month without, you know, explaining. And that they are doing that in large part by not escrowing for taxes and insurance.

Mr. KANJORSKI. That certainly answers my question.

Why should we improve disclosures for all borrowers who opt out of escrowing? And is it successful?

I listened again to some of your discussion before, in terms of notice and information at closing. I have to be honest with you guys, I probably have closed personally maybe 10 or 15 mortgages in my lifetime and hundreds of people that I have represented in business transactions. I have yet to read all of those documents.

As a matter of fact, I doubt whether I would have enough time to read all of those documents. I remember one rather sophisticated closing that took us 12 hours in Philadelphia and I think it had 158 documents that had to be executed. Certainly people would argue that there was notice, real notice, absolute notice. It is nonsense. It was legal notice.

We comply with this policy of providing a paper and giving notice, but nobody ever reads it. And to be honest with you, the way some of us write those notice documents, even if you did read it, it would be highly unlikely that you would understand what you were receiving notice on.

Yes, Mr. Taylor.

Mr. TAYLOR. Yes, Mr. Kanjorski. You are actually getting at what I think is one of the core fundamental changes in our financial services system, our mortgage lending system that has occurred. And that is when you went to closing, when the average person, not highly educated, blue-collar person went to a closing 15, 20, 30, 40, or 50 years ago, when they went in, they could rely upon the integrity of the system. You know, we just didn't have what we have now.

This is really lenders gone wild, or brokers gone wild. This is a system that really changed under our eyes. It is not the same financial system we used to have.

What is funny, we have more financial literacy, more disclosure than we ever had. That is not really solving—it is important stuff, but it is not solving it. It has to be solved by putting the integrity back in the system and that is going to take this kind of bill.

Mr. KANJORSKI. Not unlike other things in our society, perhaps, where change has occurred. The reality was, you know, in the past, you went to your local bank, you went to your local savings and loan, or your local credit union and you did a mortgage operation. You knew the people across the table, they were going to be your neighbors for life, your friends. And everyone looked out for each other.

The other day I had someone come up to me and say, "I just closed and got this mortgage and I found out that Wells Fargo is the bank which loaned me the money; I don't even know who Wells Fargo is."

And in Pennsylvania, where this transaction took place, Wells Fargo is thought of as being way across the country. But that is how fast these mortgage transactions are sold. People, as a matter of fact this individual told me this because he refused to go through with the transaction because he said, "I didn't make the arrangement to borrow from Wells Fargo." And he did not know who they were, although they are obviously a reputable bank. But the transactions are so extreme compared to the way they used to be.

Now, when we had hearings on this issue in Pennsylvania, it was peculiar. The people who had moved from New York to Pennsylvania were very annoyed with Pennsylvania, because we do not require a lawyer at the transaction to represent the buyer, where apparently in New York they do. And quite frankly, although I am a member of the Bar myself, I am rather sympathetic to that idea, that it would not be a bad idea, to have somebody knowledgeable in the law or financial transactions to protect the consumer.

I do not think all of the notices that we write or everything we do is going to really give people protection. And as a matter of fact, sometimes I believe they think we are part of the problem.

Mr. BACHUS. Would the gentleman—the last thing about Wells Fargo, you know, interestingly enough, you know, Wells Fargo told my staff and myself that they always require escrowing, just I mean one of the things we're talking about, escrowing. In fact they say that loans that aren't escrowed are bad for the lender, bad for the borrower. And that the percentage of those that default, it is one indication you can look and see, it is an indication of default.

That is why the legislation that I introduced actually, it has mandatory escrowing in subprime loans. Not, you know, the prime loans but subprime.

Mr. KANJORSKI. I have other questions, Mr. Chairman, but I have exceeded my time.

The CHAIRMAN. I thank the panel. This has been a hearing that has been very useful for me on a number of points and we are going to hear some more, because I think we have a lot of general agreement here and a recognition that a number of the specifics can be adjusted one way or another.

So this panel is dismissed with our appreciation and we will, with our appreciation for their patience, hear from the last panel.

The gentleman from Alabama.

Mr. BACHUS. Mr. Chairman, I ask unanimous consent to enter into the record a statement on H.R. 3915 by the American Financial Services Association.

The CHAIRMAN. Without objection, it will be made a part of the record.

The CHAIRMAN. Let's leave quickly, people. You can all be nice to each other outside. We have to get to dinner.

All right, we will begin the last panel with my deep thanks.

We will begin with Mr. Bradley Rock, who is the chairman, president, and chief executive officer of the Bank of Smithtown. He is testifying on behalf of the American Bankers Association and America's Community Bankers.

STATEMENT OF BRADLEY ROCK, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, BANK OF SMITHTOWN, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION AND AMERICA'S COMMUNITY BANKERS

Mr. ROCK. Thank you, Mr. Chairman.

Let me start by thanking you and your staff for consulting us on aspects of this proposal. While we still have concerns, which I will address in my testimony, we appreciate that some of our concerns have been addressed in this initial draft and we look forward to continuing to work with you as this legislation moves forward.

There is no question that many homeowners are struggling to meet their monthly mortgage payments. As home values continue to fall and adjustable rate subprime mortgages are reset, the situation is not likely to improve in the near future.

The trouble in the mortgage markets is of great concern to the banking industry. Many banks have existed for decades. And some, like my bank, have existed for almost 100 years. We know that we must be part of the solution and we are pleased to work with you to bring mortgage lending back into balance.

Many banks have already taken actions to help borrowers who are in danger of defaulting. The ABA, ACB, lenders, and others have formed the HOPE NOW Alliance dedicated to helping people stay in their homes.

A guiding principle for all of us should be steadfast adherence to high ethical standards, whether you are a banker, mortgage banker, mortgage broker, Realtor, appraiser, developer, investor or anyone involved in the real estate business and homeownership, high ethical standards should be the norm, not the exception.

The damage caused by unscrupulous sales practices has hurt us all. I hold all of my employees to high standards and the bank regulators make certain that I do.

There are several additional principles that should guide any legislation on mortgage markets. First, sound underwriting standards that are based on the borrower's ability to repay are needed in every mortgage loan. Embracing the ability to repay concept as the new legislation does is essential to protect consumers and assure market stability.

However, we are concerned that the bill includes very subjective criteria, such as offering mortgage loan products that are, quote, appropriate to the consumer. Such a vague concept will likely lead to litigation, driving up costs for both lenders and consumers. While imposing a duty of care requirement is reasonable, it must be based on objective standards that are centered on the ability to repay the loan.

Second, consistent standards are needed particularly to bring nonbank mortgage originators up to the standards applied to bank originators. Independent mortgage brokers are not subject to all the consumer protection laws and regulations with which banks must comply. And more importantly, a regulatory system does not exist to examine them for compliance even with those laws such as RESPA which do apply to them.

The bill seeks to address this inconsistency by requiring all mortgage originators to be licensed and registered. While we understand the principle here, we are concerned about the regulatory burden this will add to banks which already meet high regulatory and examination standards. It would be unfair to saddle these institutions, which generally had nothing to do with the current problems, with more burdens. Doing so would inevitably impede all types of lending to our communities.

Moreover, without supervision of nonbank originators, licensing will not be effective and may, in fact, give customers the impression that there is an appropriate level of oversight when there is not.

We appreciate the opportunity to share our views on this legislation and we look forward to working with you and this committee to find workable solutions. Thank you.

[The prepared statement of Mr. Rock can be found on page 270 of the appendix.]

The CHAIRMAN. The next witness is a frequent witness and attendee at our events here, Mr. Pfotenhauer, who is the senior vice president for government affairs and public policy of the Mortgage Bankers Association.

STATEMENT OF KURT PFOTENHAUER, SENIOR VICE PRESIDENT FOR GOVERNMENT AFFAIRS AND PUBLIC POLICY, MORTGAGE BANKERS ASSOCIATION

Mr. PFOTENHAUER. Thank you, Mr. Chairman.

On behalf of our 3,000 member companies, thank you for making us a part of this process. I would like to start by giving some credit where it's due, Mr. Chairman. As per your word, the process that brought us to the introduction of your bill has been deliberative and open.

As the markets have become more and more volatile, you and your colleagues and your staff have stayed focused. You have placed policy making ahead of scoring political points. Your staff are knowledgeable and professional. Thank you. Your approach is refreshing and it keeps us focused.

I would like to add one other thing in the general category of compliment. This bill is well thought out and if enacted, it will be extraordinarily consequential. That comment does not, of course, signal agreement. But it is intended to recognize the thought and the effort that went into this ambitious proposal and to concede up front that your hard work, justifiably gives you some insulation from the common industry charge that your bill is fraught with the danger of unintended consequence.

Indeed, I rather suspect that you intend much of the consequence that would result from this bill. Which begs the question, is your approach the right approach?

Members of the committee, if they do not understand, need to understand that if H.R. 3915 becomes law, some people will be locked out of the mortgage market, many of whom would have been successful homeowners. Lowering HOEPA triggers, establishing the ability to repay and the net tangible benefit tests and eliminating some products from the market will have this effect. The question for this committee is whether the protections this bill provides are worth that price.

Eighty-five percent of subprime borrowers are paying their mortgages on time today. It is an open question how many of these 5.3 million homeowners would even qualify for a loan under the proposed regulatory construct.

The alternative to eliminating borrowers from the market is to prepare them for the market. In that respect, we urge the chairman to tackle the lack of transparency in the origination space. Streamlining the mortgage process and improving disclosures are essential to helping borrowers help themselves.

I would like to flag two additional areas of significant concern in my remaining time. First, there is what I would call a soft suitability standard in evidence in several sections of the bill. For example, section 103 dealing with steering asks the regulators to, quote, promote the interest of the consumer in obtaining the best terms for a mortgage.

While this is guidance to the regulators and not a direct requirement for lenders, we believe that the regulators will take this guidance and either attempt to define best product for a borrower or force lenders to do so, an impossible task.

We understand that your goal is to assist consumers in identifying the best loan product for themselves. With your permission, we will work with your staff to rephrase these areas of concern in a way that preserves your intent while stopping short of encouraging a suitability standard by regulation.

Finally, let me state clearly that the mortgage bankers association supports legislation to establish a consumer protection standard in the mortgage market for any number of reasons, one of which is because the patchwork quilt of State and local predatory lending laws is an impediment to the smooth and efficient operation of a national mortgage market.

We believe that any bill must include broad preemptions that give borrowers a single consumer protection standard and give lenders the certainty of a single standard to live up to.

This bill, as currently drafted, is not preemptive. As the committee already knows, this prevents MBA from offering our support. Despite this disagreement, we would like to continue to work with you in a constructive way to improve this bill. And my written testimony suggests a number of fixes we believe will make this bill a better product.

Thank you.

[The prepared statement of Mr. Pfotenhauer can be found on page 253 of the appendix.]

The CHAIRMAN. Next, returning to the committee again to share his wisdom with us, Mr. Marc Lackritz, president and chief executive officer of the Securities Industry and Financial Markets Association.

Mr. Lackritz.

STATEMENT OF MARC E. LACKRITZ, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

Mr. LACKRITZ. Thank you, Mr. Chairman. First of all, let me commend and thank your staff for a fair and participatory process in the development of this legislation. I think you and the committee have tried to stay true to a simple principle, namely that a borrower should not get a loan that he or she cannot afford and from which he or she does not benefit. Moreover, a borrower should be able to get out of any loan that breeches this simple standard. We agree that the system works best when we can keep families in their homes.

Home mortgage credit has been more widely available at a lower cost because of securitization and the secondary mortgage market. By linking mortgage borrowers to the capital markets, the secondary markets enable lenders to provide more credit at a lower price than they otherwise could. Today, nearly 70 percent of American households own their own homes. And the beauty of our housing finance system has been its continued ability to innovate and develop new techniques to best reach and serve all the different market participants.

Occasionally, some of these techniques do not work as well as they are intended. But the abuses that have occurred are in a small segment of the lending market and the market has already adjusted.

We urge the committee to bear in mind that there are limits to the liability that loan purchasers will accept before deciding to invest elsewhere, especially due to increasing global capital flows.

We are concerned that the details of several provisions of the bill as introduced, H.R. 3915, could reduce funding from the secondary mortgage market and cut off mortgage credit for worthy subprime borrowers. We would like to work with you on addressing these issues within the scope of what we feel is a workable product in titles I and II.

First, the size of the safe harbor. Our first concern relates to the safe harbor provisions for creditors and assignees that apply to qualified safe harbor mortgages. Given the current state of the mortgage-backed securities credit market, we are concerned that only those loans qualifying for the safe harbor may be made. We understand that the theory underlying the bill is that the market will eventually price the non-safe harbor loans. But if that happens, we wonder how long it will take and what impact that will have on the economy.

Secondly, the securitizer or assignee safe harbor. Although we don't think that liability for the secondary market for actions of brokers or originators is appropriate, we do recognize and appreciate that the bill limits the exposure of the secondary market investors and trusts. The bill also limits the damages of the securitizer or the trust has should the worst case scenario arise. We believe the bill should ensure that the cure remedy is made preferable to recision.

Third, the statute of limitations, Mr. Chairman. The scope of application in section 204 should be reduced. The language effectively allows almost a perpetual application, because it is the later of 6 years or foreclosure acceleration or the mere default by a borrower of 60 days or more.

The bill relies on existing Truth in Lending Law treatment as the foundation for the remainder of the recision remedy. As such, for consistency sake, the statute of limitations for this section should be 3 years, as under existing TILA section 125.

In preemption and national standards, Mr. Chairman, our largest concern is the lack of Federal preemption of State laws. We acknowledge that the proposal tries to balance the interests of borrowers and lenders on this point. Nevertheless, we believe that the approach established by this bill should be a single national standard which is not subject to 50 variations flowing from State legislation.

And finally, the role of the Federal Reserve and the concern with regulators. We have an overarching concern with the lack of a role for the Federal Reserve in the rulemaking process. The Fed has important expertise with securitization and the secondary markets, as well as the administration of HOEPA. We believe the Fed should share rulemaking authority with the other regulators in the bill.

Thank you very much, Mr. Chairman, for the opportunity to raise these concerns with you. We look forward to working with you and the committee to craft legislation that protects homeowners while ensuring a vigorous home finance system.

Thank you.

[The prepared statement of Mr. Lackritz can be found on page 236 of the appendix.]

The CHAIRMAN. Next, Mr. Marc Savitt, who is the president of the Mortgage Center, and president-elect of the National Association of Mortgage Brokers. We appreciate the cooperation that we have had from the mortgage brokers that we have worked on legislation that will in fact probably have more of an impact on them given the current status of the law than anybody else. And we appreciate the spirit with which we have been able to work together.

Mr. Savitt.

STATEMENT OF MARC SAVITT, PRESIDENT, THE MORTGAGE CENTER, AND PRESIDENT-ELECT, THE NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Mr. SAVITT. Thank you, Mr. Chairman.

Good afternoon, Chairman Frank, Ranking Member Bachus, and members of the committee. I am Marc Savitt, president-elect of the National Association of Mortgage Brokers. Thank you for the opportunity to testify here today.

Like most of my fellow NAM members, I am a small business owner, living in the same community where I work. The mortgage landscape is much different than when I first started in this business 25-plus years ago. Today, we have a deconstructed market, origination, funding, selling, servicing and securitizing can occur separately or all can fall under one entity or be connected through affiliated business arrangements.

This is why we are especially pleased by the all originator approach taken by Chairman Frank and Representatives Miller and Watt in H.R. 3915 and Ranking Member Bachus in H.R. 3012.

We commend this committee for leadership on realizing that consumer protection should relate to function rather than entity structure. All consumers deserve the same level of information and protection regardless of where they go for a home loan.

For over 5 years, NAM has been pushing to raise the bar for entry to the mortgage profession by establishing uniform minimum standards for education, testing, criminal background checks, and by urging creation of a national registry for all mortgage originators. There are some who will push for carveouts, but doing so will dilute consumer protection and deny the market reality that all mortgage originators perform essentially the same function.

We sincerely hope that this committee holds steadfast to the all-originator construct it has advanced in H.R. 3915. Our greatest concern with this bill, however, lies with the practical implications and unintended consequences of the anti-steering provision. We support disconnecting compensation from the origination of loan products or programs, but we are concerned that current language could be interpreted as banning indirect compensation for brokers. Such a measure would destroy small business brokers in this country and hurt the consumers they serve.

As the only origination channel that makes full disclosure of the YSP on both the good faith estimate and again on the closing statement, our indirect compensation has come under intense scrutiny. Meanwhile, our originator competitors earn the same type of indirect compensation without disclosure and seemingly without disclosure and seemingly without criticism. We should not preserve the disclosure inequity created by HUD in 1992. It confuses consumers and hurts the natural order of competition.

We do not believe it is the committee's intent to legislatively pick winners or losers or further disadvantage small business in the mortgage industry. We look forward to continuing to work closely with the committee to clarify the intent and impact of this provision.

We thank Chairman Frank and Ranking Member Bachus for requesting a GAO study on the causes of foreclosures. This recently released report confirms that problems in the mortgage market today cannot be traced to a single source. Everyone participated and no one single participant is to blame.

We also have grave concerns on Title III of H.R. 3915. The language essentially prevents all but the perfect borrower from being able to obtain affordable financing. We find this unfortunate, as a key objective of many fair lending laws is to expand access to homeownership for low- to moderate-income and minority home buyers. The supply of funds is now very tight. A de facto Federal usury ceiling will tighten the market even further, denying funding to underserved markets. Tempered responses and proposals are critical in the market that is already prone to overreaction.

Although not specifically addressed in H.R. 3915, we commend Representatives Kanjorski and Chairman Frank and others for proposing the Escrow, Appraisal and Mortgage Servicing Improvements Act. NAM supports this effort in this bill.

In crafting proposals, we must remember that the mortgage industry is a business and that the market participants compete. NAM looks forward to continuing to work with this committee as well as respective regulators on accomplishing solutions that are effective in helping consumers without hurting small business.

Thank you, and I'm happy to answer any questions.

[The prepared statement of Mr. Savitt can be found on page 281 of the appendix.]

The CHAIRMAN. Thank you, Mr. Savitt.

Finally, Mr. Don Lampe from Womble Carlyle Sandridge and Rice. Mr. Lampe.

STATEMENT OF DONALD C. LAMPE, WOMBLE, CARLYLE, SANDRIDGE AND RICE, PLLC

Mr. LAMPE. Mr. Chairman, thank you for the opportunity to be here today. And I will be brief, because it has been a long day and everyone here has been very attentive.

I have been involved on behalf of industry trade organizations, mortgage lenders and others, either as a legal consultant or registered lobbyist in the enactment of many State mortgage laws, recently including laws in Georgia, Kentucky, Tennessee, Oklahoma, New Mexico, Ohio, Rhode Island, Minnesota, North Carolina, and Montgomery County, Maryland.

Because much of the legislation, and I'm speaking of course of H.R. 3915 that the committee is considering today, is based on residential mortgage lending laws in North Carolina, I hope to be able to respond to the committee's questions regarding our experiences in North Carolina. And, in this regard, North Carolinians are proud of the leadership, thought, and passion that Congressman Melvin Watt and Congressman Brad Miller of this committee have brought to the issue of predatory mortgage lending.

As a legislative body, you are faced with tough policy choices as to what you should do about what is being described as the mortgage mess, the subprime meltdown and the foreclosure crisis. As you know, Americans are looking to Congress to lead the country on a safe path through the mine field that is residential mortgage finance today.

In the brief time that I do have, I would like to make three points that in my view bear additional attention by this committee as it considers the legislation. These points are built around a central theme. First and foremost, it is critically important that any legislation achieve the appropriate balance between providing strong and effective consumer protections while preserving access for consumers to fairly priced, nondiscriminatory, lawful, and appropriate mortgage credit.

The three points are as follows. And, Mr. Chairman, in accordance with your opening statements, I offer these comments constructively to you and to Congressman Watt, who is also a sponsor of this bill and to the committee.

The first point is, as you have heard today, this legislation applies across the board to all residential mortgage loans. While there may be agreement that unfair mortgage lending practices, particularly when coupled with higher priced or risk layered consumer mortgage products cannot be condoned and should be legislated out of existence, it is far less clear that all borrowers of any loan secured by their dwelling need or want additional across-the-board legal and regulatory restrictions.

My second point is that it appears that the design of the statute, particularly as to liability, is designed to mitigate legal risk to loan originators and loan purchasers. This approach assumes that avoidance of litigation risk, rather than prudent yet flexible lending standards, is what should drive market conduct. Responsible compliance-oriented lenders, the likes of which we would like to see more of in the market, find litigation to be an anathema and have no desire to build compliance policies and procedures simply on choices that minimize damages in lawsuits.

My final point is that we observe in the bill and again, trying to comment constructively here, that the bill ironically in pointing away from flexibility and innovation in the mortgage market, because we think this over-aggressive innovation got us into this mess, the legislation may actually be at odds with accepted mandates of fair lending and nondiscrimination in mortgage lending.

At one time in our history, too many lenders knowingly discriminated based on suitability of particular home mortgage borrowers, using factors that at the time seemed, "reasonable," and "in good faith." Today, such rationalizations in the name of discussion are totally unacceptable. Yet the legislation appears to mandate credit determinations based on a list of factors that must be considered to the detriment of other factors that could actually benefit a particular borrower.

In closing, I make one closing comment, and it does appear, even though we have not had much time to study the bill, that I believe it would make sense for this committee and the Congress to consider whether consumers and lenders alike are better off and better served by the relative simplicity and uniformity of central, unifying Federal standards in any comprehensive mortgage lending law reform.

Again, thank you for having me here today and I am happy to answer any questions.

[The prepared statement of Mr. Lampe can be found on page 241 of the appendix.]

The CHAIRMAN. Thank you.

Let me just begin, and this process has been useful. Mr. Lackritz, the statute of limitations issue that you raised, our colleague from Kansas, Mr. Moore, and I talked about that on the floor. And I think he made the point, obviously, he has had discussion, I think he makes a very good point, and that is an example of something that I think we will be able to accommodate and tighten up on the statute of limitations. Obviously, uncertainty is a problem.

There are other areas in terms of the standard, again, I think we have an agreement on the goal about what kind of loans you don't want. We will work on it.

I do have to say on preemption, people have said we must have a uniform Federal standard. Do we have one today? Do we have a uniform Federal standard governing lending?

Mr. Lampe, you say we don't. Does anybody think we have one today? Why didn't you ask us for one last year?

Mr. PFOTENHAUER. We did.

The CHAIRMAN. What, for a uniform Federal standard? In what form?

Mr. PFOTENHAUER. We were strong supporters of Mr. Kanjorski's bill, Ney-Kanjorski, which put forward a uniform consumer credit standard. We have been asking the committee for this standard for 6 years.

The CHAIRMAN. And it would be—and I will say I had not seen that one in particular. I mean, we have State banks run by State bank regulators. I am trying to understand what a uniform standard means.

Does that mean that if we put in a Federal standard, that the State bank regulators would then have to administer that Federal standard? They would have no flexibility to deviate from that? I am talking now about State-chartered banks.

Mr. ROCK. Yes, I think they would have to. That exists currently with respect to other Federal standards are administered by State bank regulators.

The CHAIRMAN. So what you would like to see is a uniform set of standards for mortgages that would apply to every State and the State bankers—I guess the question is why? Now here is the issue for me. With regard to the securitizer liability, I think there is an argument for uniformity because you have one national market. And it would be conceptually possible to require a uniform standard from which there was no deviation as part of the securitizer liability package, namely the safe harbor.

But what is the harm done if in other areas the State decides that it is going to enforce stricter standards? What is the public policy argument against that? It wouldn't affect the safe harbor, it wouldn't affect securitizer liability. What is the public policy argument that says no State should be allowed to impose a stricter standard?

I say that because, as we talk here, I think there is a great deal of uncertainty. We have said no one can be dogmatic. We are going to define what is suitable and what isn't suitable. Why should there not be for the States and their residential property mortgages, as long as it doesn't affect the securitizers' liability, why shouldn't they have some flexibility? What is the harm that is done there?

Mr. ROCK. Well, I think you make a good point. I think it would be an overstatement to say that unless we have a uniform Federal standard, you know, that will destroy the secondary market. I think that would be a gross overstatement. We would prefer a uniform standard because we think that that will promote a very liquid secondary market.

The CHAIRMAN. Let me say this, Mr. Rock. I want to separate them.

To the extent that it impacts directly on the secondary market, I agree. I do think there is an argument for uniformity there. So I would say yes, for the safe harbor definition, there ought to be uniformity.

But over and above that, if a State says, and here are the standards we are going to put into the mortgages, I don't see what Federal imperative says they shouldn't do that.

Mr. ROCK. I think to the extent that you have greater deviation from a uniform standard, we risk some damage to the secondary market. To the extent we have deviation from that. I don't say that it instantly—

The CHAIRMAN. How does that hurt the secondary market? Here is the deal. For purposes of qualifying for the safe harbor, theoretically, there would be a uniform standard. But not involving the safe harbor, just the States could say you can't make these—State-chartered banks can't make mortgages that don't meet these standards. How does that hurt the secondary market?

Mr. ROCK. This would be the impediment. I call to find—

The CHAIRMAN. How does that hurt the secondary market?

Mr. ROCK. This is the way. I call to buy a mortgage-backed security. They quote the rate. The yield is pretty high. I say, I want to know what the collateral is underlying that. They tell me it is a group of mortgages in the State of Michigan. I may or may not know what the standards are in Michigan. I may inquire and find out they are different from New York. That may—

The CHAIRMAN. They would be higher. But we would only allow them to be higher. So I don't understand how that would make you less likely to buy it. We are talking about higher. We are not talking about letting the States go lower.

Anyone else?

Mr. PFOTENHAUER. You could have a liability associated with it that would—

The CHAIRMAN. What is the liability? What do you mean?

Mr. PFOTENHAUER. Whatever a State came up with. There is certainly going to be an additional compliance cost associated with—

The CHAIRMAN. Yes, if you want to do business in my State, you have to comply with my laws. That is not a great evoker of sympathy.

Mr. PFOTENHAUER. We are doing it today. It is changing. We will do it more this next year if we don't pass a bill in Congress, because States are acting. But it is driving up the costs of loans.

The CHAIRMAN. Well, that is a distinction States can make. And the States can say—and I think, again, we are going to compromise at the standard. Everybody—there seems to be broad agreement that we should set a standard of what loans should be made and what shouldn't be made.

I don't understand why we have to, approximating that standard, which we have to do, then have to say, and no State can deviate from that, no State can decide it wants more protection.

Whatever happens to federalism in that situation? Mr. Lackritz?

Mr. LACKRITZ. No, I think the distinction you started to draw is a worthwhile distinction between the secondary market and the origination piece. And I think it is terribly important, as you were pointing out, in the secondary market, to have uniform standards because you have interlinked global financial capital markets basically.

From the standpoint of origination, it seems to me you can provide more flexibility as long as there is—

The CHAIRMAN. Right, and from the standpoint of worrying about buying it, it presumably has a higher standard not a lower one, so it shouldn't make you all that worried.

My time has expired.

The gentlewoman from Ohio.

Ms. PRYCE. Thank you, Mr. Chairman. This has been a very long day, but a very productive one. And I appreciate the witnesses being so patient and we didn't have that many votes, but by the same token, they did interrupt our first panel twice.

So I want to go on a completely different tangent. Because as I sat here today, and I listened back in the office, it occurred to me, you know, we hear all these figures, 34 percent of homeowners have no idea what kind of mortgage they have, according to some polls. And is there a place, as we examine what to put in this bill, for a financial literacy component, something similar to you have to go to school to give haircuts, you have to go to school to adopt a pet, you have to go to school to buy a gun in some States. You know, you have to be prepared.

This is the biggest financial decision most families make in the course of any of their lifetimes, and I don't think that most people are prepared. I think that is part of what has happened. And so how do we do this?

You know, Ranking Member Bachus's bill has a suggested statement of mortgage facts that have to be on the front page, and then it says at the bottom, do not sign unless you understand this. Now that maybe is a good first step. But it is just one of hundreds of pages that somebody is supposed to understand before they sign.

And how can we, how can you, how can the originators or how can the industry help America reach a level of literacy that they need in order to complete these complicated transactions? And you know, you can lead a horse to water, but you can't make him drink. And caveat emptor and all that good stuff. But have you given that any thought and is there a way that we can help America get to where they need to be?

Any and all of you can jump right in here.

Mr. ROCK. Well, Congresswoman, we fully support anything that can be done to increase financial literacy. In fact, last week, the American Bankers Association conducted what we call Get Smart about Credit Day. We had more than 3,000 bankers across the country trying to help people with these very issues.

Having said that, that we support them and that we are open to any other ideas, I think that it would be very difficult to mandate something in advance of being—you know, your analogy to, say, getting a gun license or something, to mandate it, to say you must have “X” education or go through a course before you can get a home mortgage, I think that might put more burden on the consumer than the consumers might like.

Ms. PRYCE. Well, they might not like it, but maybe they need it.

Go ahead, Mr. Lackritz.

Mr. LACKRITZ. First of all, you have identified a terribly important issue and one that, I know, we care a great deal about and have worked on for a long time, not just in the home finance area, but broadly speaking with respect to economic literacy and financial literacy.

We clearly don’t want to license home buyers.

Ms. PRYCE. No, and I agree with that.

Mr. LACKRITZ. And we clearly don’t want to license investors.

So what we do is we look, in the regulatory structure, what we try and do is we try and regulate the middle people, the intermediaries, basically, because they are the ones who are interfacing with the customers and the other side of the markets.

And it works more effectively with educated consumers. Obviously, the better educated the consumers are, the better the whole system works. It’s a win/win for everyone.

We have a program in the schools to educate kids about the capital markets and the stock market and it is wildly successful. Now, whether or not that translates over time into greater financial literacy, I am not sure. But I think those kinds of efforts in the schools, requiring economic or financial literacy will go a long way toward helping us educate consumers, because they are bearing much more responsibility for their own financial future.

Ms. PRYCE. But it is a piecemeal, kind of everybody jumps in and has their own little program. And it is not, you know, uniform. I don’t know that it is getting us where we need. We have been talking about it.

Kurt?

Mr. PFOTENHAUER. You know, there is a demand for this. We had 1.6 million hits on our Web site last month alone, homeloanlearningcenter.com. People want to know what goes into a home loan.

There is also an element of the market that will teach people. If we can streamline the mortgage process and people go through it and they actually compare one product to another, and get other lenders to teach them what the guy next door isn’t telling them or what a better deal is or what a good deal is, and you do that a little bit, people learn a lot and you get better results.

Finally, you can look at the schools, and I know that is beyond the purview of this committee.

Ms. PRYCE. What about just putting the terms of the loan on the monthly statement? You know? Some people just don’t even know what they are. Would that be burdensome or would that be bad in any way to re-inform the consumer each month, you know, what the term is, when it is due? Are there prepayment penalties? Those type of things. You know, a lot of people, obviously 34 percent, don’t even know.

Mr. SAVITT. Congresswoman, one thing that we can do is clearer disclosure. There should be not only clearer disclosure, simpler disclosure and uniform disclosure. This will make it easier for the consumer to understand exactly what program they are getting into, what type of loan they are getting into.

The problem we have today is, depending upon who the originator is that you get your loan from, there are different types of disclosure.

As far as financial literacy goes, I agree with this gentleman here, that financial literacy should start in the schools. In the school district where my children go, there is financial literacy.

Ms. PRYCE. Well, but that is beyond our purview. And it should, but it isn't happening. Americans aren't educated to the extent they can.

Does anybody object to requiring the loan terms on the monthly statement? Is that—

Mr. ROCK. I think it would depend upon the level of detail required. I mean, a lot of those loan statements currently do include the things that you have just listed.

Ms. PRYCE. I have four and none of them do.

Mr. ROCK. Well—

Ms. PRYCE. And so I just—

Mr. ROCK. Ours do and many that I have seen from others do. But I think it would depend upon the level of detail.

Would it be onerous not to have maybe the four or five things that you have mentioned. But if it went beyond that, it could perhaps be onerous.

Ms. PRYCE. Well, my time has expired. And thank you. This is a very, very broad bill and we only touched on a very small part of it.

So, thank you, Mr. Chairman.

Mr. KANJORSKI. [presiding] The Chair recognizes himself.

I ask unanimous consent that the written statement of Maureen McGrath on behalf of the National Advocacy Against Mortgage Servicing Fraud be admitted into the record.

Is there any objection?

Hearing none, it is so ordered.

I want to compliment everybody, particularly this panel for waiting around as long as you did to get here. We appreciate it.

If I had to say anything, having gone through this frightful experience in the past, as you all know, I wanted to thank and compliment the chairman and two of my colleagues that put a lot of effort in to get this far.

There are a few elements in my estimation that are important, one, that I am particularly interested in finding some way of getting a standard, a national standard that we can rely upon. I think it is important.

And coming from the other angle of what Mr. Frank asked about, first of all when we went into the issue a number of years ago, we found that there were a multiplicity of municipalities that had exercised their right under their individual State laws to pass mortgage rules and regulations. These rules and regulations now require the securitizers to have counsel go back and examine every municipal code to see whether or not they had enacted something that affected the value of that mortgage or whether the mortgage complied with the local ordinance or statute, which I think is ludicrous.

Two, the lack of uniformity drove—I think it was New Jersey and Georgia—the subprime market to almost collapse, because they were just excluded from securitization. Why bother to mess with them if they are too expensive and too difficult to deal with?

I think that is where the North Carolina statute came from. It finally found the ground on which people felt comfortable in dealing.

On the other hand, feel that there is another side to that. And then when you look at the law of mortgaging, I was just telling my good friend, Maxine, here, if I were a banker, I would not write a mortgage in California if my life depended on it. Because as I understand the law, as compared to Pennsylvania, if you are dissatisfied with your mortgage and your property, all you have to do is hand in your keys and whoever gave you the mortgage gets the property and you are excluded.

Now, that does not happen in Pennsylvania. In Pennsylvania, the property is just a partial support asset for the mortgage. You actually have to have a personal judgment note with all your assets supporting the property. So, as a result, when you look at Pennsylvania borrowers, the property, or the real estate is the last asset that they will put at risk, because to escape it is practically impossible. It follows you to the grave.

On the other hand, in California, when there is a collapse of the price of the market, people look across the street and see a house selling for $100,000 or $200,000 less than they have on their mortgage, they are apt to say, "Well, I will get out of this, turn my mortgage in and go and buy the house across the street and I have just made $200,000." I see that happening in many States in the Union.

I think what it boils down to is, is securitization good? Particularly, is it a useful tool in subprime areas? And I have mixed feelings on it. I will tell you some of them.

I think we, the Government, both the Executive and the Legislative Branches, are to a large extent responsible for what is going on today. We encouraged, I remember, this magic formula—70 percent. We had to get homeownership of over 70 percent.

Quite frankly, there are a lot of people who are not sufficiently trained or financially literate enough to become owners of property. And I will give you an example. I held hearings in Pennsylvania, and some residents from New York came in and bought homes in the Pocono Mountains of Pennsylvania. And the one lady at the hearing said, "Well, I am incensed. After I bought my home, the refrigerator broke 18 months after I bought it, and I called the Realtor and asked, what are you going to do about replacing this refrigerator?" And he said, "Nothing, lady." And she said, "Well, that's just wrong; it's his responsibility to replace that refrigerator."

And, you know, it is understandable, I guess. If that is what—she just did not realize she was in ownership as opposed to tenancy. I think that is an unfortunate reflection of what we are dealing with.

But when you are in that margin of the market, the last 2, 3, or 4 percent of homeownership, they should not be denied homes, but we have a greater responsibility to make sure these people are not abused or misused. They are certainly subject to a lot of abuses out there, and we have seen so many of them.

Then I think of some of our testimony earlier. If I have to condemn anything in this system, there are probably 8 or 10 steps from the person who originally attracts a buyer for a piece of property, either a Realtor or the owner of that property, and then going through the financing operation until at the bottom some investor buys that bond that is securitized by that mortgage.

If you think about it today, nobody along that line, eight or nine people, have any skin in the game. Everybody makes a profit if they sell a higher cost mortgage, if they sell something overpriced, a bad appraisal, all kinds of things, they all gain more. But nobody has any skin in the game to lose anything until you get to the last guy on the totem pole, the investor. And even he gets skin for the last time. He did not buy a bond; some money manager bought it and got a commission on sticking him with something that said it is a triple A when it was junk.

And now suddenly, all over the world, these people are looking at us here in the States and saying, "How can you trust these people?" And that is the question. What we do in this bill and as we correct the subprime and the whole operation of securitization, I really believe is a matter of faith in the United States of America. There is an implied judgment around this world that if we allow securities to be securitized and sold worldwide, somebody is looking over the fact that these are not boiler room hot potatoes that have no value. And we failed to do that. We failed to do it here, gentlemen, your institutions fail, the regulators that were here before you, they fail. All of that fault we have endured. What do we do about it?

I would hope that your testimony today will help Chairman Frank find some of these important basic areas toward achieving a national standard. I think that is important. I think if we are going to have a continuation and the use of securitization in mortgaging in this country and indeed some day around the world, we are going to have to find a better way, more transparency, more security, less abusiveness in the system.

I want to thank you for your testimony. I had a few questions but I do not have the time to ask them at this point. I just had to blow off my steam. I have been listening to you up to this point.

The CHAIRMAN. The gentleman from Louisiana.

Mr. BAKER. Mr. Savitt, I'm an old real estate guy, emphasis on old, and I know you mortgage guys well. So you're going to have to help me understand what's going on here. Let's zero in on DTI and how that calculation works, and going to a mortgage broker's web page, I left here a minute ago when Mr. Sherman was talking because it triggered something and I had to go look it up to make sure I was right. Typical, conventional loan criteria for a DTI uses the 28:36 ratio, where 28 percent, typically of gross income, is allocated to house note and principal. Is that still the case?

Mr. SAVITT. That's the standard rule, but you have to remember that every situation is different.

Mr. BAKER. That's okay. Let me keep going, because I'm on a roll.

Mr. SAVITT. Yes, okay.

Mr. BAKER. The second part of it, the 36 part, goes to the cost associated with operation of the household as car payment, credit card, child support, any of the obligations that typically go with a mortgage.

Mr. SAVITT. It includes not only your monthly payment, but again your new mortgage payment as well. That's all included in the DTI.

Mr. BAKER. So when they're doing this calculation, I'm using now for members a $42,000 annual salary, a gross of $3,500 monthly. The calculation they came to was that $980 can be applied directly to principal and interest, and $1,260 can be applied to recurring housing expense for a gross expenditure of $2,240 out of a gross income of $3,500. You have to assume 15 percent is a minimum, State and Federal tax load; so when you crack it back down on a conventional loan, you have a household with about $3,000 max coming in a month with an ability to have $2,240 in total obligations.

I took that number and worked it through to get what percent of gross income that actually turns out to be. A typical, conventional loan at the max is about 64 percent debt to income ratio. What was really interesting was I went to my old FHA friends, and they have a $2,941 rule, FAS forward, that's $2,450 a month, which is a 70 percent debt to income ratio.

My observation here is is we adopt the underlying bill without some modification. FHA loans are outside the safe harbor. Now, that's problematic. That has to have a real market consequence to people, because when I apply the numbers in the bill to the same set of circumstances, that $1,750 a month, housing and housing related expense.

So I merely wanted to bring this up. And, is there anything I'm missing, Mr. Savitt, in that descriptive analysis of how markets function today? Are the FHA numbers basically still on target because programs change?

Mr. SAVITT. They are still on target, but again, you know, even though that is a high debt to income ratio, it depends upon the borrower's financial circumstances.

Mr. BAKER. Right. They may have $200,000 in the bank from a prior home sale. They may have an investment portfolio. They may be a Federal employee with a TSP account with several hundred thousand dollars.

Mr. SAVITT. Right, there are several compensating factors.

Mr. BAKER. They may have paid a note for 22 years and never missed a monthly payment. They may have a sick uncle who has a bunch of money and they know they're going to come into good fortune here. I mean, there are all sorts of reasons to look at each individual's borrower's assets and determine whether in this unique set of circumstances, he was appropriately placed in a financial obligation which he can meet the terms over the long haul.

I think the rub has been that perhaps that due diligence didn't always take place in every case, and I didn't bring them with me. I should have, but I went to some of the Web pages talking about "no-doc" loans, where they take pride in announcing they don't verify your income. Now, that to me has gotten outside the bounds of propriety, and we really need to deal with that. But I think we need to be very careful as we go forward in drafting this proposal as to the real market consequences to borrowers who otherwise have access to credit now, who will not, if we adopt the provisions of the bill as it is currently proposed.

Do you agree, Mr. Savitt?

Mr. SAVITT. Absolutely.

Mr. BAKER. Thank you. You're a great witness.

I yield back.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

It's been a long day and I thank you for not only holding this hearing but for the way that you have entertained all of the members who have participated and the patience that you have exhibited in trying to help us gain information about how to do the best possible job in dealing with not only the problem that we are confronted with today for the future, but also predatory lending.

To the panel that's before us, you have a lot at stake here. You have a lot at stake here because we are discussing banning yield spread premiums. We are discussing no-doc loans, pre-payment penalties, teaser rates, securitized liability, on and on and on. I want to get right to the part of the bill that basically bans yield spread premiums, and I would like to start with—is it Mr. Rock? I can't see from here.

Mr. ROCK. Yes, yes.

Ms. WATERS. I don't know if it was you who started to talk about how perhaps this is not the right thing to do, that you would be placed at great disadvantage. And I want to know is that because you think that the requirements that we place on the banks for their employees would not match the requirements that we place on you relative to, number one, their need to be licensed, and number two, how they are paid or not paid for their loan originations?

Mr. ROCK. No. I did not make any of those remarks that you're referring to, but just to comment on yield spread premiums, in most circumstances that I am familiar with where they're used, I think it's a bad practice.

Ms. WATERS. I'm sorry. He just reminded me that I'm really speaking to the brokers and not the bankers on this. So who would like to respond to that? Mr.—

Mr. SAVITT. Savitt.

Ms. WATERS. Okay.

Mr. SAVITT. That's me.

[Laughter]

Ms. WATERS. All right, Mr. Savitt.

Mr. SAVITT. Congresswoman, first of all, I think there's a great misconception about yield spread premiums. Yield spread premiums, and I've been a broker for over 25 years, yield spread premiums are a very useful tool in helping its consumer, a borrower, get into a property with less money up front, less money for closing costs, less money for down payment. And our brokers have been accused of using yield spread premiums as an incentive to make more money, and I think what people are failing to recognize is every time you raise your yield spread premium, you're raising your interest rate.

If you raise your interest rate too high, you're not going to get that transaction. Somebody else, another originator, will get that transaction. And the fact that brokers do, depending on who you talk to, anywhere between 50 and 70 percent of all the residential loans in this country, that tells you that brokers are not doing that. You may have some originators, not just brokers. But you may have some originators, possibly abusing back-end fees, whether its a YSP or, of course, the lenders all get service release fees. We disclose this incidentally. Nobody else in the market discloses it. We've been required by HUD since 1992 to disclose yield spread premiums on the good faith estimate, and also on the HUD 1 settlement statement.

So I'm sure you understand how frustrating it is for us with all of the news accounts that have come out over the past several months that brokers must disclose all of their fees up front. There's no mention about lenders doing this, and it's kind of ironic, because brokers are the only ones who disclose their fees.

Ms. WATERS. So, if lenders had to disclose, would that make you feel better?

Mr. SAVITT. If lenders had to disclose, it would make it more transparent to the consumer. There would be less confusion. There are a couple of FTC studies that came out and said because brokers are the only channeled distribution that disclose yield spread premiums, the consumer is often confused into picking the more expensive transaction. He looks over the broker, lists the yield spread premium on the good faith estimate. He thinks that as an extra charge. The consumer thinks it's an extra charge when in fact it's not.

When the FTC conducted their study, I forget how many people they actually had involved in the testing, but in most cases they purposely made the lender good-faith estimate more expensive than the broker good-faith estimate, but consumers more often than not picked the broker good-faith estimate as the more expensive deal because they were confused by the chart.

Ms. WATERS. Okay, well, let me just say this. And I've been one of the supporters wanting to ban it, and I'm still not sure why we shouldn't ban the yield spread premiums. I hear what you're saying, but you haven't made the case why yield spread premiums allow you to assist the borrower more with the borrower paying less money. I don't get it.

Mr. SAVITT. Well, Congresswoman, I have a rate-sheet here from the West Virginia Housing Development Fund. That's one of the States I'm licensed in. This is a first-time home-buyer bond program. West Virginia, as Congresswoman Capito mentioned before, has the highest rate of homeownership in the country. They also have one of the lowest foreclosure rates in this country. We're ranked number 47th in a country in which we're all very proud of. Of course, even one foreclosure is one too many. But this is a government agency paying their lenders and brokers either a YSP or an SRP because they understand that this helps consumers become homeowners.

Today, consumers have very little savings. They have very little money to get into a house. So by being able to use or take the benefits of a yield spread premium, it helps them become homeowners with less up-front in cost for their down payment in closing cost. And as I mentioned before, lenders get the exact same thing, but they do not have the requirement to disclose.

Mr. ROCK. I would just point out with respect to that point that the brokers—an essential difference is that the brokers—hold themselves out as representing the buyer, whereas, the lender does not hold themselves out that way.

Mr. PFOTENHAUER. In addition, there's a very different set of market disciplines on someone who works for a commission versus someone who lends their own money, and that's the key difference between.

The CHAIRMAN. Would the gentlewoman yield to me?

Ms. WATERS. Yes, I yield to you.

The CHAIRMAN. Sir, how does that help the consumer? How does paying a yield spread premium help the consumer? I guess I don't fully understand that.

Mr. SAVITT. First of all, Mr. Chairman, when a consumer calls shopping around for an interest rate, what they ask for is a zero point rate, whether it's a broker or a lender. That's what they ask for. So we receive a yield spread premium for that rate as a lender would receive a SRP.

The CHAIRMAN. Well, then a yield spread premium—am I wrong that we're talking about your compensation? Who pays you the yield spread premium?

Mr. SAVITT. The lender.

The CHAIRMAN. The lender does?

Mr. SAVITT. Correct.

The CHAIRMAN. And what do you do to earn a yield spread premium from the lender?

Mr. SAVITT. We originated the loan, we processed the loan. We prepared the loan.

The CHAIRMAN. Yes, but that's basically. When does the premium come in?

Mr. SAVITT. The premium is the difference between the wholesale and the retail rate.

The CHAIRMAN. So that the higher the case, what's the relationship between what the lender charges the consumer and the yield spread premium?

Mr. SAVITT. I don't understand your question.

The CHAIRMAN. Is there a relationship between the yield spread premium and the rate the lender charges a consumer?

Mr. SAVITT. There is, just the same as in an SRP.

The CHAIRMAN. Well the higher the rate the lender charges, the higher the yield spread premium?

Mr. SAVITT. The higher the rate, the higher the yield spread.

The CHAIRMAN. And explain to me how that helps the consumer.

Mr. SAVITT. I'm sorry?

The CHAIRMAN. Explain to me how that helps the consumer.

Mr. SAVITT. Because consumers all want for the most part zero points loans, so if you take a lender and you take a broker, and let's say the interest rate for a 30-year fixed is 6½ percent, they're both making the same amount on that loan. They're both being paid for that loan.

When a lender originates a loan, and it's not just brokers that broker loans. When any originator—

The CHAIRMAN. I'm lost. You lost me.

Tell me how it helps me as a consumer if the person who I'm dealing with is going to make more money if I pay a higher interest rate?

Mr. SAVITT. Less up-front money; it's less money out of their pocket.

Ms. WATERS. How?

Mr. SAVITT. And in some cases, it may pay for their closing cost.

The CHAIRMAN. Well, that's always the case, that the higher interest rate is always off-setting lower closing costs and lower up front? Is that always the case? That's a simple question. I'm skeptical of that. I'm skeptical that there's always that relationship.

Mr. SAVITT. Well, the consumer has the choice of paying points too if they want to pay the origination fee.

The CHAIRMAN. I know, but that's not the question.

Is it never the case that everything else being equal, the higher the interest rate I'm charged the more money the yield spread premium will be?

Mr. SAVITT. On any YSP or SRP, yes.

The CHAIRMAN. Okay. I don't see how that helps me. I mean, if everything else is being equal, say you can say points.

Mr. SAVITT. Mr. Chairman, I can't stress enough, it does help consumers.

The CHAIRMAN. How? If everything else being equal the higher the interest rate, the higher the yield spread premium, how am I helped?

Mr. SAVITT. Because it's still a competitive rate that regardless of who the originator is, it's still a competitive interest rate. And the benefit is—

The CHAIRMAN. No, you're missing my point. You say it's competitive, but it would have been lower. It does not give the broker an incentive to find me a loan with a higher interest rate?

Mr. SAVITT. No. It doesn't, because the consumer always has a choice. We put options in front of the consumers. They always pick what's best for them.

The CHAIRMAN. And it does not incentivize the broker at all?

Mr. SAVITT. No. It's not. It's something that benefits the consumer, and, again, we have a State housing agency that oversees it.

The CHAIRMAN. Well, the fact that a government agency does something does not always immunize it, you know, from the charge. I assume you would agree with that.

Well, I've taken too much time.

Mr. SAVITT. Can I say one more thing?

The CHAIRMAN. Quickly. This is the gentlewoman's time.

Ms. WATERS. Let me just say, because I know that you want to move on, that you have not made the case. And this is not what we understand as we have dealt with this issue. And so I'm looking for ways to really understand whether or not the consumer is disadvantaged, whether or not there is steering that would cause the originator to be able to make more money based on the higher priced product, and you are not helping us very much.

Mr. SAVITT. Congresswoman, I think there's a misconception. You're talking about the anti-steering provision in the bill.

We're talking about two different things here. We're talking about YSP as indirect compensation and we're talking about receiving extra compensation for steering somebody into a loan that has no benefit for them.

The National Association of Mortgage Brokers agrees with what you have in the bill as far as banning additional compensation, but we want to make sure that it is not being construed as our normal indirect compensation. This is something that is an additional amount of money, because if it's a zero point loan—and this is the easiest way I could describe this—if it's a zero point loan, regardless of who the originator is, whether it is a mortgage broker, a bank, a mortgage banker-lender, whoever it happens to be, everybody gets money on the back end of that loan, if it is a zero point loan.

That's where they receive their compensation, indirect compensation.

Ms. WATERS. Well, let me just say that under Section 103 our anti-steering section provides that no mortgage originator can receive and no person can pay any incentive compensation, including yield spread premiums that is based on or varies with the terms of a mortgage loan.

Mr. SAVITT. But that should not be construed as indirect compensation for a broker. We're talking about in that provision, we're talking about additional compensation for steering somebody to a certain type of loan. That's not what we're talking about. When brokers are trying to protect the yield spread premium, it is indirect compensation. It does definitely provide a benefit to the consumer, just like a lender receives a service release premium for doing the exact same loan. The only difference is we disclose that. The consumer has full disclosure at the time of application and also at the time of closing.

The CHAIRMAN. The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

As a conservative, I typically prefer non-legislation to legislation, however, in this particular situation I think that it's the exception and not the rule and that some legislation is in order.

I think I've heard some hopeful comments from the chairman that perhaps his bill is a work in progress. I understand that much of this legislation appears to be prescriptive, dealing and trying to ensure that we don't replicate the situation that we see today. Having said that, I continue to be concerned that we're not out of this forest yet.

If we take a snapshot of where we are, it's alarming. I'm not sure we'd quite call it a crisis, but when I see $600 billion in adjustable rate subprime mortgages due to readjust in the next 2 years, I'm certainly convinced we're not out of the forest. And so I guess my concern here is if we pass this bill in its current form, as many folks attempt to refinance over the next couple of years, what exactly is going to happen to liquidity in both our primary and our secondary markets. And I think that Mr. Lampe saw some testimony there where you commented on this phenomenon.

Mr. LAMPE. Yes, Congressman, I think when you strip away some of the legalities of this and you look at the presumptions that could provide a rebuttal to it and the safe harbor, and so on, I think the message of this bill is don't make a loan unless it is a qualified mortgage or a qualified safe harbor mortgage, because the secondary market will not want to absorb it.

And so, the other aspect of this, which I don't think this is controversial, if you lower the high cost home loan triggers as has been done in provisions of this law, then any loans that are above those triggers won't be made. So, I think the bill on its face and I think the bill's intent was to restrict loans outside of these safe harbors or above these thresholds from being made. And then the only question is how big a piece of the market is that?

Mr. HENSARLING. Now that is a good question. Does anybody else on the panel wish to comment how much a piece is left out there for all these people trying to refinance? Any takers? Mr. Lackritz?

Mr. LACKRITZ. Yes, Congressman. I think we just don't know that yet. Clearly, the design of a safe harbor acts as a magnet for underwriting mortgages and the issue of how many non-safe harbor mortgages will get written eventually. Markets react over time to external and exogenous events, and so markets will obviously react here. It's just a question of how long that will take, and whether or not the variety and the availability of the credit will continue to be as expansive as it has been. Clearly, it's going to restrict. In the short run it's going to narrow the availability of credit in those particular areas.

Mr. HENSARLING. Mr. Pfotenhauer?

Mr. PFOTENHAUER. Just to give you one, I'm sorry. It's not a definitive answer, but just to give you a little bit of scope in what we are dealing with and I would agree that we can't quite define the issue today or the impact, but there were, according to HMDA data, there were 10 million loans made in 2006. 3.9 million of those are basically subprime, all-day loans.

So, that's the universe; you know, nearly 39 to 40 percent where we have a big question mark over whether or not those are actually going to get made. And they're going to be cross-pressured in different ways by this bill going forward. Now, to be fair, there isn't a lot of liquidity in the market today in the private label, subprime space. And so we are talking about what happens going forward.

The market is already disciplined very severely, the players in this area, and has yet itself to come up with the mechanisms that allow it to go forward. It will. It will figure out a way to make these loans again with or without Congress, but how far it goes in that and how far it goes in the future is really what this panel is debating.

Mr. HENSARLING. Mr. Pfotenhauer, in speaking of some of your concerns with the legislation, I think you used the phrase "soft suitability standards." Could you elaborate on your concerns?

Mr. PFOTENHAUER. Section 103 and Section 104 contain concepts like best loan for a consumer, most appropriate loan for a consumer, and pretty much appear to turn that work over to a regulator. Having had some former regulators on our staff look at that language, they feel that the language might compel the regulator to try to come up with some sort of suitability formula.

You know, that really gets you down a slippery slope with the plaintiff's bar, because what's a suitable loan is really something that we think should be determined by borrower, not by the lender. And if the lender has anything beyond the duty of care, which is a reasonable thing to have provided it's structured correctly, then you're really working in reverse of your intentions on this and potentially shutting down lending to the very people you want to help.

Mr. HENSARLING. Okay. I probably don't have an option, but I think I'll go ahead and respect the 5-minute rule anyway.

The CHAIRMAN. I thank the gentleman.

The gentleman from North Carolina.

Mr. WATT. I think it was worth sitting here all day just to hear Mr. Hensarling say that this is an area that we need to do something in. That's a radical statement coming from Mr. Hensarling. I don't think I've ever heard that phrase come out of his mouth. So it was worth sitting here just to hear that.

I want to go back to the issue that Chairman Frank raised about pre-emption, not that I'm expecting to convince anybody on this panel, but just to make sure that we have it on the record what my position is on that. I really think that's kind of a smoke screen, because to the extent that we set a satisfactory Federal floor standard, if States get substantially out of line with their requirements, lenders are going to leave those States.

Credit is going to be more expensive in those States and those States are going to have to come back to a responsible Federal standard, whether we called it a preemptive standard or not. That's always been my position. The problem with Federal preemption from my perspective is that we can't act and our regulators, nor certainly our legislative body doesn't react quick enough to deal with changes that the market is constantly going through; and, so, there has to be for those entities that are outside Federal regulators, even if Federal regulators could react quick enough or if we could react quick enough at the Federal level to change the law, which we never would, there will always be somebody out there with a new product, a new process, a new something or another that is not regulated if we don't leave discretion with the States to address those concerns.

So, I mean, I've had this discussion with everybody from your industry just come through my office and I've said it over and over again, but I think for us to spend a lot of time arguing about whether we are federally preempting or not, when we set a responsible Federal standard, which I think everybody has kind of agreed now the North Carolina standard is if other States get too far away from that standard, they're going to pay a price for it, either in the form of higher interest rates or in the form of loss of available money to loan in that State.

So I just don't think that's something I'm going to spend a lot of time talking about, and I think there are other ways to address the concerns about whether we pre-empt or don't pre-empt or whether we partially pre-empt. But clearly we have to leave the ability of the State to be able to react in areas that are not federally regulated. And we have to leave the States the ability to react when they can react quicker to changes in the market. So those are the two things that I want to put down as markers.

Mr. Rock, you stated and I see you and Mr. Savitt, it's going to be hard to reconcile your views, I think, because you say you need supervision of the non-regulated entities you all have supervised and you have all of these people out there who are not supervised. So how would that look, that kind of supervision to the non-regulated that you testified? And I think that's the phrase you used.

Mr. ROCK. Well, banks are highly regulated and highly supervised. I mean, the second half is very important because we are being examined all the time to make sure that we are complying with the rules and regulations that we must confirm with. I think that the segment of the industry, the non-bank segment of the originators, should be brought up to that level, and I think that's the way to achieve equality.

Mr. WATT. Okay, so, if we brought brokers up to that standard, Mr. Savitt won't be all that happy, but you think that would help to solve the problem?

Mr. ROCK. I think it would, given the fact that non-bank originators presently originate, we estimate, approximately 58 percent of all home mortgages, and yet, that segment of the industry which initiates a majority of the originations is not subject to the kind of regulations.

Mr. WATT. I have to give him equal time, because I know Mr. Savitt wants to respond.

Mr. SAVITT. I think that there are 50 bank supervisors out there who would have a difference of opinion with Mr. Rock. Mortgage brokers are regulated. We're regulated in all 50 States. I'll use myself as an example. I am licensed by two different States. I have continuing education requirements. I have surety bond requirements, and I am examined on a regular basis.

Mr. WATT. I'd feel better about that if the person who testified for your industry had been able to tell me who he worked for. I asked him, I mean, I'll go back and show it to you in the record. I can't remember who the guy was. I'm just asking do you represent the borrower or do you represent the lender and I never could get an answer out of him.

Mr. SAVITT. The problem that we have is—well, not a problem—if somebody comes into a mortgage broker's office, the individual that they meet with for their loan application is regulated by that State.

If that same individual walks across the street to a bank and deals with the individual loan officer in that bank, that loan officer is not regulated. The bank may be regulated, and, we've heard things recently in the news that you need to deal with the institution that has the eagle on the outside of the building, because they're FDIC approved.

That's fine, but we're not talking about the lending side, and, on the lending side, they don't go through as much scrutiny as mortgage brokers do. Mortgage brokers are under a magnifying glass. As I said, we're regulated in every State. We are examined in every State, and there are proper safeguards to make sure that when somebody comes into a broker's office, they are dealing with somebody who is reputable.

Mr. WATT. Okay, well, my time is up. I just want to be clear that if I'm walking into a lender, I at least know that they are not currently being hired to represent my interest. I'm trying to get a loan from him. When I walk into a broker's office, I think 99 percent of the people who walk into the broker's office think that broker is working for them.

Mr. SAVITT. Can I just answer?

The CHAIRMAN. Quickly.

Mr. SAVITT. Brokers still have an ethical responsibility and we exercise that ethical responsibility every day to our customers. That's why we have the amount of business that we do, because we live in the communities. We work with these people; our children go to the same schools.

Mr. WATT. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Connecticut.

Mr. SHAYS. Thank you, Mr. Chairman. Thank you for holding these hearings. I'm not used to seeing you penned-down for a whole day. How are you holding up?

The CHAIRMAN. Oh, I'm in a pretty bad mood.

[Laughter]

Mr. SHAYS. Well, actually, you look like you're in a bad mood, but you're a good man.

I want to say that when I view this I feel like there was a noticeable earthquake and then we felt after shocks; and what's kind of looming is this tidal wave. And I asked the first panel when they thought that title wave of foreclosures happens and the panel was basically saying, you know, it started and that the second and third quarter of next year. I'd like to ask each of you when you see the bulk of foreclosures coming to the marketplace, if we just start right down the line.

Mr. ROCK. Well, I would agree with much of what was said before. I think a lot of the rate resetting is one of the causes in some of these situations. I think a lot of the rate resetting has begun now.

Mr. SHAYS. I'll ask you by cause. I just want to know what happens first.

Mr. ROCK. Now, and I would expect it to continue through next year.

Mr. SHAYS. I'll come back to you though.

Mr. ROCK. Yes, sir.

Mr. PFOTENHAUER. We at the Mortgage Banker's Association think that we will work through this and start to turn around by the third quarter of 2008.

Mr. SHAYS. But will it be bigger before it gets smaller?

Mr. PFOTENHAUER. No, actually, we are through the biggest part. It's not going to drop dramatically. It's going to be somewhat high next year as well.

Mr. SHAYS. So, basically, you think the tidal wave has hit?

Mr. PFOTENHAUER. Yes.

Mr. LACKRITZ. We think it's peaking in this quarter now and that it will start to taper off and get better next year.

Mr. PFOTENHAUER. I would agree it's leveling off.

Mr. LAMPE. Yes, we're at the front end of it now and it will continue into the first and second quarter next year.

Mr. SHAYS. First and second quarter—we were talking about the renegotiations of the loans and the explanation to me was that since some of these are packaged, that presents a bit of an issue in terms of who services the loan. And the question I'm asking is would the renegotiation of the loans actively now be something that will mitigate the ultimate effect of this?

Mr. ROCK. It's such a multi-party relationship. I think that's very difficult. And Mr. Calhoun went through a valiant effort before to try to explain some of the difficulties, and I think it's extremely difficult, Congressman.

Mr. PFOTENHAUER. I think it can be said that servicers who are the ones in the front lines of loan modification have incentive and have means to modify loans. What's not clear is how many people can be successfully modified into a new loan and thereby stay in their home and continue to make payments. It's hard to put a number around how many there are that actually qualify for that, because the causes of foreclosure and delinquency are so varied.

Mr. SHAYS. Right, but there is a huge incentive to not have the foreclosures.

Mr. PFOTENHAUER. There's an enormous incentive not to have a foreclosure today.

Mr. SHAYS. Yes, sir?

Mr. LACKRITZ. I would agree with that. Obviously, it's not in anybody's interest to have increased foreclosures at all. The challenge is to find the right balance in there because you have investors. You have securitizers. You have originators. You have borrowers and you have the taxpayers. And trying to balance that system as it's evolved is a complicated exercise.

So part of the point of, I think, this hearing, is to urge you to be very careful as you go through this. Because obviously, tilting the system in one way or the other, will have ramifications to all the participants in the system and may have ended up hurting the very individuals that you want to help.

Mr. SHAYS. Thank you.

Mr. SAVITT. I would agree with that as well.

Mr. SHAYS. Thank you.

Mr. LAMPE. I would agree with Mr. Pfotenhauer's analysis.

Mr. SHAYS. Mr. Rock, you wanted to make a point. What was the point you wanted to make? I interrupted you.

Mr. ROCK. I was just saying it has a lot to do with rate resetting. That was my only point.

Mr. SHAYS. With regard to a lot of these, you know, we pushed all of you to loan to people of color, minorities and so on. And in the process we took great pride that we're seeing these loans being made, and, now, we realize that some benefitted and some have been hurt badly.

But is it your view that some of these loans probably will be in the best interest for people just simply to walk away from the loan?

Mr. PFOTENHAUER. Clearly, people are electing to do that today.

Mr. SHAYS. Yes.

Mr. PFOTENHAUER. There are many people who got into a loan for very little money down. They maybe had a piggy-back second and now they own a home whose value has gone down.

Mr. SHAYS. But likely while they may lose their home, they may not have lost an investment of any. They may not in fact have lost anything because they hardly put anything down.

Mr. PFOTENHAUER. They may not have lost any net worth. They may be greatly inconvenienced, and it may be hurtful to their family to leave.

Mr. SHAYS. Judging from the morning of my chairman, I'll just close by saying to you, Mr. Savitt, I've depended on mortgage brokers for probably ten—refinancing, maybe seven—with two different homes; and, I always felt well served by the individuals who have helped me.

Mr. SAVITT. Mr. Shays, may I say one thing about that? I just want to clarify something before to make sure that what I was saying was understood, that we support banning the incentive compensation. I want to make that very clear. But, we don't want to have our ability to earn a living banned. Indirect compensation is how mortgage brokers—

Mr. SHAYS. I think we understand that.

How are you doing, Mr. Chairman? Are you okay?

The CHAIRMAN. Yes, one more if you want.

Mr. SHAYS. Okay.

The CHAIRMAN. Let me just ask—did you want to say something?

Ms. WATERS. If I may.

The CHAIRMAN. Go ahead.

Ms. WATERS. I wanted to clear up something. I know that Mr. Shays on two occasions had talked about the mortgages that are made available to minorities and others who perhaps, you know, could not afford them. Someone said today that most of the problem was in refinance and that the people who were refinancing had bought homes that they could afford.

It was not where the problem was that the mortgages were so much being extended to folks who had nothing, could not afford them, maybe not even deserve them.

Will someone please clear that up? I don't know who said that.

Mr. SHAYS. If the gentlelady could just yield. The point I had made and I was corrected was that I was making the assumption that these subprime loans were for basically new buyers. And it was pointed out a lot of these folks were people who already had a decent mortgage, but were tempted to get into an unstable mortgage. I think that's the point.

The CHAIRMAN. I think Mr. Gruenberg, the Vice Chair of the FDIC in fact made that point very strongly, partially corroborated by Comptroller Dugan.

Mr. SHAYS. Yes, and I appreciate you making that point.

Ms. WATERS. Thank you.

The CHAIRMAN. I just want to close with a couple of points, and I appreciate the constructive suggestion.

Do any of the members of the panel think that we should in fact not bother to legislate at all, that we're going to do more harm than good. Does anyone think that we should just leave the status quo?

Mr. Lackritz?

Mr. LACKRITZ. No, Mr. Chairman. I think the point is just to urge you to move carefully in this area.

The CHAIRMAN. As opposed to whether we could move or not.

Mr. LACKRITZ. No. I don't mean to make light of that.

The CHAIRMAN. All right, secondly, I want to make a statement, because people have said, well, this is going to restrict credit. Yes. Let me ask you this. Do you think that all of the loans that were made over the last couple of years in the subprime area should have been made?

Mr. Rock?

Mr. ROCK. No.

The CHAIRMAN. Mr. Pfotenhauer?

Mr. PFOTENHAUER. No, sir.

The CHAIRMAN. Mr. Lackritz?

Mr. LACKRITZ. No.

The CHAIRMAN. Mr. Savitt?

Mr. SAVITT. No.

The CHAIRMAN. Mr. Lampe?

Mr. LAMPE. Okay, so if you all think that there were loans that were made that shouldn't have been made, of course, we're going to restrict credit.

Now the job is to restrict credit in a somewhat precise way. You're never going to get to perfection; you're never going to ban only bad stuff and leave good stuff. We believe that you can move the line closer. You've been helpful with us, but please don't tell me that the problems that we're going to restrict credit and expect to be credible, because we need to restrict credit.

The problem was credit was improvidently granted to a significant number of people on terms or in circumstances in which they shouldn't have gotten it. That's what's happened. What we need to do is to try to find a way to restrict the wrong kinds of credit. But of course it's going to restrict credit; if it weren't going to restrict credit, then we would sill have the same thing.

Mr. Savitt, did you want to respond?

Mr. SAVITT. Mr. Chairman, first I want to congratulate you for the contents of this bill and also one part in particular, which is the registry for all originators.

The CHAIRMAN. Yes, we're going to do that. We're working with the minority on this and we will have that registry. I also think, by the way, and this goes to the bank situation, we're not talking about licensing people. We are talking about having—the wording may get cleaned up—but we are talking about keeping track of everybody who is doing this.

Mr. Lackritz, I cut you off before.

Mr. LACKRITZ. I think the only point I wanted to make, there was credit that was obviously and prudently or improvidently granted. But I also think at the same time it's important to take a lot of pride in what the committee has done, and the industry has done to broaden the circle of homeownership. Don't ban that.

The CHAIRMAN. I would also want to know this, and this is my more philosophical point, I wish everybody in America earned enough money to own a home. I also I wish that I could eat more and not gain weight, and that I didn't get as tired today, that I had more energy than I had 20 years ago.

One of the mistakes we made, I think, was to equate a decent place to live with homeownership. Homeownership is a very good thing. It's good for people. It's good for the neighborhoods, but it's not the only form of housing. And there will always be millions of people in this country who, because of their economic circumstances—leave aside wealthy people who did it by choice—won't be able to own a home, particularly in certain areas of the country, where the gentleman from Connecticut lives, where I live, and where my colleague from Los Angeles lives.

And we make a mistake if we push people into homeownership who shouldn't be there, and part of that is, and it's part of the agenda of this committee, to create some alternative and decent and affordable rental housing, and I think we need to have the mix. I would mention one other thing that didn't get mentioned today and it's very relative to us. One of the things in this bill, which I think is most important, is the provision that says that a foreclosure does not extinguish a lease. Because of all the people we could say, well, the borrowers were imprudent. This one was imprudent.

The tenants were rarely imprudent, and what we have are people who were living in housing and paying their rent on a regular basis, and because of a foreclosure, they've been hit with evictions. Now, we're going to say going forward that shouldn't happen. I would urge all of you to the extent that you have any control over the property, please don't kick people out just because the landlord foreclosed.

There's a degree of cruelty that's not personally oriented that has been visited on people. So we are saying that we have in this bill that foreclosure does not extinguish a lease. And I think that's a very important point. And please don't wait until the bill comes to act on this. People who are paying their rent, I also must say, from the standpoint of the people foreclosing continuing to have a tenant makes it a lot less likely that all the pipes are going to wind up in China because people are stealing all the copper. And it's better for the neighborhoods too.

I would just urge people to take that into consideration. I thank everybody. This really has been a hearing that has had a very important impact on the specifics of this legislation.

[Whereupon, at 6:36 p.m., the hearing was adjourned.]

A P P E N D I X

October 24, 2007

Statement of Representative Kenny Marchant
October 24, 2007
Committee on Financial Services hearing on "Legislative Proposals on Reforming Mortgage Practices"

Thank you Chairman Frank for holding this hearing today. I applaud the Chairman for his goal of putting an end to predatory lending. Unscrupulous lenders taking advantage of hapless borrowers must be stopped. However, the rhetoric on this issue has reached such a fever pitch that it seems that many are now equating predatory lending with sub-prime lending. This is incorrect. Sub-prime lending represents the road to homeownership and the American dream for millions of Americans who would otherwise not be able to get a mortgage. In Congress's ever-present urge to rush and "do something" about the sub-prime issue, I believe that we will end up hurting the very people we are trying to help.

Before now I always thought this was conventional knowledge, but let me state that foreclosures are not good for anyone involved. When a house is foreclosed upon, it hurts the consumer that took out the mortgage, it hurts the originator of the mortgage and it hurts everyone all the way into the secondary market. This is why it is already not in

anyone's best interest to make a loan that the consumer cannot repay. I do not believe we need any new laws to tell us that.

In addition, the vague language in this bill coupled with the increased liability prescribed will add up to a huge surge in lawsuits, which will lead to dried up credit for the very people this bill purports to help. The sub-prime market will cease to exist and the bipartisan goal of increasing homeownership in America will slip out of reach.

I believe a much more cautious approach than this bill is warranted. Thank you for my time Mr. Chairman and I look forward to the testimony.

TESTIMONY OF

STEVEN L. ANTONAKES

MASSACHUSETTS COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES

Before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

October 24, 2007

Room 2128, Rayburn House Office Building

Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Steven L. Antonakes, and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. I am also the Chairman of the State Liaison Committee (SLC), making me the newest voting member of the Federal Financial Institutions Examination Council (FFIEC).[1] I am also a founding board member of the Nationwide Mortgage Licensing System. It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors (CSBS). Thank you for inviting us here to comment on legislative proposals to reform mortgage lending and brokerage activities.

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's 6,182 state-chartered commercial and savings banks, and 400 state-licensed foreign banking offices nationwide. For more than a century, CSBS has given state bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of state bank regulation. In addition to banks, most CSBS members also have licensing and supervisory responsibilities for mortgage companies.

States have been active in mortgage regulation since the 1980s, when the first states passed mortgage broker licensing laws. All 50 states, plus the District of

[1] The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the State Liaison Committee (SLC) and to make recommendations to promote uniformity in the supervision of financial institutions. The FFIEC website is http://www.ffiec.gov.

Columbia, have now adopted some form of regulatory oversight of the residential mortgage industry. By the most recent count states have jurisdiction over more than 90,000 mortgage companies nationwide, with 75,000 branch locations and around 370,000 loan officers and other professionals.

Chairman Frank, Representatives Watt and Miller, we commend your dedication to protecting consumers, and to promoting the principles of responsible lending. CSBS supports the direction of H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007 to improve consumer protections and regulatory standards. Additionally, we applaud the work that Representatives Bachus, Gillmor, and Pryce have done on H.R. 3012 to address lending abuses, and that would facilitate the creation of a nationwide supervisory database for the mortgage lending industry.

CSBS looks forward to working with Congress and our fellow financial regulators to develop a more coordinated state/federal system to address today's developing foreclosure crisis and the ongoing regulatory challenges of the evolving mortgage finance industry. Many factors have contributed to the current state of the mortgage market. Restoring consumer confidence and stability will take cooperation from state and federal regulatory authorities, Congress and state legislatures, members of the industry, and consumers.

For the last four years, we at the state level have been working on solutions to the challenges raised by the revolution in mortgage finance, and the fragmented system in place to supervise its players. CSBS began with a vision for a national licensing system, and has moved on to coordinated regulatory policy with the federal banking agencies, enhanced examiner training, and pilot programs for coordinated examinations of mortgage lenders. Our goal, like yours, is a streamlined, consistent system of oversight that protects consumers and enforces best practices while maintaining a stable flow of credit through our markets.

We appreciate that the Miller-Watt-Frank bill acknowledges and builds from work that is already being done in the states to protect consumers and restore the public trust in our mortgage finance and lending industries. CSBS sees the need for improvement in our current supervisory framework, and we are taking those steps. It is vital that any new federal legislation support and enhance existing state and federal efforts to improve supervision and enhance consumer protection.

Addressing the Issue at the State Level

The housing market, so fundamental to the U.S. economy, is facing enormous challenges. The changes in the residential mortgage market over the past two decades have been dramatic and far-reaching. This evolution has had a number of benefits, including a vast flow of liquidity into the mortgage market, increased availability of credit, and higher rates of homeownership.

The evolution of the securitized mortgage market has also, however, created moral hazard by redistributing the risk of loan defaults through contractual agreements that begin with the local broker, and end with a Wall Street investor. This dispersal of risk has created opportunities and incentives for some actors to engage in weak underwriting or fraud.

While CSBS believes that this new model's long-term strengths outweigh its current failings, securitization changed the incentives within the industry, and the industry's internal controls did not keep pace with these changes. The failure to identify and implement these internal controls now threatens both our housing market and our economy.

States have been seeing and responding to problems created by weak industry controls for some time. States have acted to pass licensing laws and laws against predatory lending, and these laws now serve as models for the legislative proposals we are discussing today. This role of states as models for federal action is a long-standing benefit of our dual banking system, and one CSBS has discussed on many occasions in previous testimony.

Recognizing that the traditional model of state-by-state autonomy was not appropriate for an industry that combines the most local of financial products – a home mortgage – with a global system of finance, CSBS began four years ago to develop a more coordinated system. The core of this coordinated system is the Nationwide Mortgage Licensing System (NMLS). The NMLS helps accommodate the changes in state law that have extended supervision beyond the company to the individual, creating standards for professional qualifications and practices that will protect consumers and help give them more information on who they are doing business with. The scope of this project is enormous, as I will discuss, and it covers a universe of mortgage providers too large to be supervised by any one agency.

States have also pursued unprecedented cooperative efforts with our federal counterparts in areas such as guidance for nontraditional and subprime lending, and pilot programs for coordinated and cooperative supervision of subprime lenders.

To address our immediate challenges, state attorneys general and bank regulators have been meeting with industry representatives to explore ways to minimize the impact of rising foreclosure rates. In September, a working group of attorneys general and bank regulators, led by Iowa Attorney General Tom Miller, spent two days meeting with the ten largest subprime servicers, in a cooperative effort to find ways to avoid foreclosure and modify loans that may still be viable. Over the next two weeks, the working group will meet with the next ten largest subprime servicers, as the top 20 comprise more than 90% of the industry.

Earlier this year in Massachusetts, in response to the growing foreclosure crisis, Governor Deval Patrick directed my office to work with lenders and servicers in order to secure a delay in the foreclosure process. The purpose is to allow consumers a little time to consider their alternatives, including a loan workout, and to encourage consumers to seek foreclosure counseling. Since April 30^{th}, the Massachusetts Division of Banks has secured 30- to 60-day delays in the foreclosure process for nearly 500 Massachusetts homeowners who have called my office. Many other states have similar initiatives underway.

Industry representatives have agreed to share information with state officials in order to help us track the problems that are having such an impact on our communities. We were pleased to see the Treasury Department's HOPE NOW announcement, which sets goals similar to our own. CSBS has asked the federal agencies to work with state officials on this effort, as coordination is essential to success. As we are most directly experiencing the impact of foreclosures within our states, a state role is essential to any effort to work with servicers.

Congress has the opportunity to build upon this new system of state and federal cooperation. At the state level, we have already begun to identify and address the weaknesses in applicable state law and oversight of the mortgage lending and finance system. Because mortgage lending is a local activity, and foreclosures so devastating to local economies, states must be at the core of any solution to this problem, and should be able to respond to future problems as they develop. State regulators, with the offices of the state attorneys general, have the resources and experience necessary to address these issues at the homeowners' level.

At the same time, we look to this Committee to complement this regulatory system by setting minimum federal lending standards based on the states' collective experience, and provide the same transparency for the capital markets that states seek to provide for consumers. We also urge Congress to make sure that the states are included in any new federal rule-making processes for mortgage providers. The FFIEC, already in place with a voting state representative, provides the most appropriate forum for developing these new rules.

The Nationwide Mortgage Licensing System

The increased coordination of the supervision and regulation of mortgage companies across state lines has highlighted the need for a central nationwide source of information. To that end, CSBS and its sister organization, AARMR, have created the Nationwide Mortgage Licensing System (NMLS) to serve as a foundation for residential mortgage supervision. State supervisors have been the first responders to the problems experienced in the residential mortgage market, and have garnered considerable amounts of information and expertise. All state-to-state coordinated supervision is linked to the NMLS; therefore, it is absolutely vital that any federal legislation support this system because of its essential role in our supervisory coordination. We appreciate that the Miller-Watt-Frank and the Bachus-Gillmor-Pryce bills both incorporate this initiative into the framework of a nationwide mortgage originator licensing and registration system.

The goal of the NMLS is to ensure that consumers are protected from fraudulent practices. The NMLS seeks to improve the efficiency and effectiveness of the U.S. mortgage market, to fight fraud and predatory lending, to increase accountability among mortgage professionals, and to unify and streamline state licensing safeguards. This system is scheduled to launch on January 2, 2008, and it will allow companies and individuals to be tracked across state lines and over any period of time.

The benefits of this nationwide system to consumers, the industry, and state supervisory agencies will be immediate and profound. Consumers will have access to key information about providers. Honest mortgage providers will benefit from the creation of a system that drives out fraudulent and incompetent operators, and from having one central point of contact for submitting and updating license applications. Investors will benefit from the knowledge that the loans they have purchased were originated by a provider with a clean record. All market participants will benefit from a system that makes it easier to identify and punish the small percentage of dishonest operators in the mortgage industry.

Again, we appreciate that both the Miller-Watt-Frank and Bachus-Gillmor-Pryce bills facilitate the creation and operation of this system. We encourage the Committee to consider elements of the Bachus-Gillmor-Pryce bill not included in the Miller-Watt-Frank bill that would allow state and federal mortgage regulators to share information about licensed professionals without the loss of privilege or the loss of state and federal confidentiality protections; protect the Nationwide Mortgage Licensing System against civil actions or proceedings for monetary damages in the case of good faith errors; and facilitate FBI background checks for the states.

The Uniform Predatory Lending Standard

CSBS supports a more uniform predatory lending standard, provided that the federal standard is a floor, rather than a ceiling, and that states have clear authority to take enforcement actions against violations. States have taken the lead in this area, with 36 states plus the District of Columbia enacting laws against predatory lending. North Carolina was the first to do so, in 1999. These state laws supplement the federal protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA), and have led to significant changes in industry practices. All too often, however, we have been frustrated in our efforts to protect consumers by the preemption of state consumer protection laws by federal agencies.

A federal anti-predatory lending standard should state clearly and unambiguously that lenders must consider a borrower's ability to repay a loan. This affordability standard should include all of the costs of homeownership, not just the monthly payment. Our concern has been that borrowers too often do not understand the characteristics and risks of the products they are purchasing.

The states have taken action to close what they perceived as gaps in HOEPA; now, the proposals you are considering today look to those state laws as models. This is federalism at its best. Markets change, industries change and laws need to change. Any federal legislative proposal must preserve the states' ability to address new problems as they emerge.

It is time for an update to HOEPA to incorporate the time-tested consumer protections implemented by the various states over the last decade. CSBS is pleased that the Federal Reserve Board has committed to a public release of HOEPA amendments in the coming months.

Preserving the States' Role

Fourteen years have passed since the original enactment of HOEPA. In that time, we have seen a revolution in mortgage finance, and the states have developed regulation and legislation to supervise the industry. Not all of these efforts have been successful, but through the experience of trial and error the states have created a supervisory framework and identified a set of best practices. Now, through Federal Reserve rulemaking, or changes in federal law, those best practices developed by the states can be incorporated into national standards.

The role the states have played in mortgage supervision can not be overlooked. Of the four landmark predatory lending cases that have created the common law framework for the industry, three originated from state action. Household, the largest predatory lending case in history, began with a single state investigation in 1999 and grew to a nationwide settlement benefiting hundreds of thousands of consumers by 2002. Even as that case was drawing to a close, the states were initiating the second largest predatory lending case in history, against Ameriquest. These cases have set the legal precedents for all subsequent predatory lending cases.

However Congress chooses to improve consumer protection for mortgage finance, it is important to support the states' ability, through legislative and enforcement authority, to protect consumers from emerging problems. It is crucially important not to undercut the work we have already done. Federal legislation should build on state expertise and efforts to protect consumers.

Coordinating Supervision and Enforcement

Building on the experience and best practices of state regulation means increasing coordination and cooperation not only among state regulatory agencies, but also with all federal agencies responsible for the oversight of the mortgage lending industry. Regulatory turf battles must become a thing of the past; our joint imperative is consumer protection and the restoration of confidence, stability, and sound principles of responsible lending to the marketplace.

The states, therefore, have launched ground-breaking initiatives with our federal counterparts, and look to Congress support of these efforts. Three major examination initiatives are well underway.

The first of these was the publication of interagency guidelines for mortgage providers. The states applauded the federal agencies' Guidance on Nontraditional Mortgage Product Risks and the Statement on Subprime Mortgage Lending, and developed parallel guidance for state-supervised entities. Beyond that, however, the states have taken the lead in establishing a new environment for lending policy, and have begun to implement that policy at the local level by giving state examiners a detailed set of model examination procedures to test and monitor each provider's adoption of these guidelines. Those procedures were formally released at the end of July, and three federal agencies have already adopted them as the examination tool to be employed in joint federal/state examinations.

CSBS and AARMR will soon release a detailed training course available to both government and public reviewers of subprime lending practices. This holistic approach to training is intended not only to help outsiders evaluate a business, but also to help the businesses themselves make systemic changes to their practices. Our goal should be not to just tell the industry what it's done wrong after the fact, but to show them how to operate in a manner that protects consumers in the future.

The second major initiative began with the early successes of state predatory lending enforcement cases, and continues to the present day with multi-state examination and enforcement alliances that work across state borders and regulatory jurisdictions. In addition to the nationwide actions, state regulators took more than 3,600 enforcement actions in 2006 alone.

CSBS and AARMR facilitated a meeting of state mortgage regulators in Boston to formalize a multi-state protocol and agreement on this combination of state examination and enforcement resources. My colleagues and I are encouraged by this multi-state effort, as state supervisors continue to move toward a more coordinated and consistent supervisory framework.

The third initiative is the joining of forces with our federal counterparts in two unique pilot examination programs. The first of these pilots brings state examiners together with examiners from the Federal Reserve Board, the Office of Thrift Supervision and the Federal Trade Commission to conduct simultaneous examinations of mortgage companies whose separate charters cross federal and state jurisdiction.

The second pilot project is a coordinated effort among the OCC and the states of New York and Massachusetts. This examination will place state examiners in loan origination companies at the same time as the OCC is examining the federally-chartered institutions that acquire loans from those originators. Both pilots will provide a window into the mortgage lending process, from origination to funding.

Conclusion

As I said in my opening remarks, proper supervision of the residential mortgage market will require a coordinated effort from both federal and state authorities. Congress has the opportunity to make more than stop-gap repairs to the supervisory framework. Congress has the opportunity to create a new system of state and federal coordination for protecting homeowners and enforcing best practices in the mortgage lending industry.

While housing finance may be global, borrowing and home ownership – and, sadly, defaults and foreclosures – are local. Creating a new federal regulator would be neither efficient nor realistic, given the nature of the mortgage market. As I noted, the sheer volume of providers makes it impossible to imagine a single federal agency that could oversee them all. When it comes to protecting consumers, even globally funded mortgages are originated locally.

The solution, instead, is a coordinated federal and state supervisory framework that will provide both transparency and protection to all participants in the mortgage market, and restore the public trust. CSBS is already taking steps to create such a framework. We appreciate the efforts your legislation makes to improve consumer protection and enhance industry standards. CSBS looks forward to working with you to further ensure the efforts of state officials.

Thank you for inviting me to testify on this important subject today. I am pleased to answer any questions the Committee may have.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES

before the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

October 24, 2007

2128 Rayburn House Office Building

Chairman Frank, Ranking Member Bachus and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding legislation to address recent practices in the mortgage market. In its prior hearings this year, this Committee has carefully documented developments in the mortgage market that have resulted in harm to consumers and the economy.

As I have testified previously, the events that have led up to the recent market disruptions and problems in the mortgage market demonstrate how weak credit practices in one sector can lead to a wider set of credit market uncertainties that can affect the broader economy. Although these events have yet to fully play out, they underscore my longstanding view that consumer protection and safe and sound lending are really two sides of the same coin. Failure to uphold uniform high standards in these areas across our increasingly complex mortgage lending industry has resulted in serious adverse consequences for consumers, lenders, investors, and, potentially, the U.S. economy.

For borrowers, there are 2.07 million subprime first-lien hybrid adjustable rate mortgages (ARMs) outstanding that were made in 2005 and 2006, most of which have or will reset in 2007 or 2008. While about 311,000 of these are currently seriously delinquent or in foreclosure, the size and volume of resets also suggests the potential for serious financial distress among the remaining 1.75 million households whose loans are subject to reset.[1] For investors, the uncertainty that now pervades the mortgage market -- which is directly attributable to underwriting practices that are unsafe, unsound,

[1] FDIC calculations based on the Loan Performance Securities database updated through June, 2007.

predatory and/or abusive -- has seriously disrupted the functioning of the securitization market and the availability of mortgage credit.

The FDIC recognizes the importance of home ownership. We also recognize that responsibly underwritten loans to consumers with less than perfect credit profiles can be prudent and profitable assets, provided that institutions have the necessary expertise and capital support to manage them in a safe and sound manner. Moreover, the FDIC is committed to the goals of the Community Reinvestment Act of 1977, which has long encouraged extending home mortgage credit to low and moderate income communities. Clear, balanced, common sense standards regarding mortgage lending practices will reinforce market discipline and preserve an adequate flow of capital to fund responsible lending.

Returning to Fundamentals

The financial system has changed dramatically in recent years. Changes in technology, delivery channels and funding sources have resulted in financial products that are more complex and marketed through increasingly sophisticated methods. In addition, there has been increased participation in the mortgage market by providers other than insured banks and thrift institutions. For example, approximately half of subprime mortgage originations in 2005 and 2006 were carried out by companies that were not subject to examination by a federal supervisor. The proliferation of securitization as a funding method also has changed the financial system by moving large volumes of assets off the balance sheets of federally-insured financial institutions.

Unfortunately as the industry changed, many risk management fundamentals were ignored or weakened. To be sure, fraud has played a role in some portion of troubled loans, particularly those that exhibited early payment default. However, the core of the problem lies with lax lending standards and inadequate consumer protections resulting in a widespread failure to underwrite loans to borrowers based on their ability to repay.

The impact of poor underwriting practices has spread throughout the economy in recent months, harming consumers and investors while creating volatility in the financial markets. Legislative action by this Committee and rulemaking by the Federal Reserve Board under the Home Ownership and Equity Protection Act (HOEPA) hold out promise that mortgage originations will return to the standards and fundamentals that have served us well for many years.

In my June testimony before this Committee, I listed several elements that should be included in national standards for mortgage lending. Among other things, I suggested these standards should include the following elements:

- Underwriting at the fully indexed rate, which would go a long way toward helping borrowers avoid loans they cannot repay, and would improve the quality of lender portfolios and mortgage backed securities;
- A "bright line" presumption against affordability if the loan, including taxes and insurance, exceeds a debt-to-income ratio of 50 percent;

- A prohibition on stated income loans in the absence of strong mitigating factors;
- Restrictions on prepayment penalties;
- A requirement for a system of licensing and registering mortgage originators that addresses activities by entities that operate outside the supervision of the federal banking regulators or on a multi-state or nationwide basis.

In addition, any legislation or regulation to improve mortgage standards should address misleading or confusing marketing that prevents borrowers from properly evaluating loan products. The standards should require that marketing information for adjustable rate mortgages include a benchmark comparison of the rate and payment being offered by the same lender for a traditional 30-year fixed rate mortgage. The standards also should require that all rate and payment disclosure information include full disclosure of the borrower's monthly payment at the fully amortized, fully indexed rate, not just the introductory rate -- consistent with the approach of the guidance that the FDIC and other agencies have issued.[2]

A statute or regulation that includes the elements described above would establish strong national lending standards that would provide significantly enhanced protections for consumers, and greater transparency of the true costs and risks of financial products backed by these types of mortgages for investors.

[2] Interagency Guidance on Nontraditional Mortgage Product Risks, 71 FR 58609 (October 4, 2006); Statement on Subprime Mortgage Lending, 72 FR 37569, July 10, 2007.

The Mortgage Reform and Anti-Predatory Lending Act

The Mortgage Reform and Anti-Predatory Lending Act of 2007, includes a number of provisions that would address many of the standards described above. The proposed bill provides a workable and helpful vehicle for legislative action to establish proven underwriting standards for bank and non-bank lenders. Certain provisions of the bill would help ensure that borrowers receive mortgages that they can ultimately afford to repay and that lenders understand the risks of their credit decisions.

The requirements in the proposed legislation that mortgage originators be licensed and registered will improve the professionalism of mortgage originators and ensure that bad actors cannot move from one jurisdiction to another to continue their harmful activities. Many types of brokers, such as those in the insurance and securities industries, are already subject to extensive registration regimes. It seems appropriate that brokers working with borrowers on the largest financial investment most will ever make also should be subject to appropriate licensing and registration requirements. In furtherance of this objective, the Conference of State Bank Supervisors has been working to establish a nationwide database identifying all licensed mortgage brokers. The FDIC has been supportive of this effort and agrees that improved licensing and registration will benefit the originators, as well as consumers.

The provisions of the bill establishing minimum standards for mortgages also include many criteria that have long been used by lenders to evaluate a borrower's ability to repay a loan. These include requiring verified and documented financial information, considering all applicable taxes, insurance and assessments and underwriting based on the fully indexed rate assuming a fully amortizing repayment schedule.

It is especially important that the bill also mandates consideration of a borrower's debt-to-income ratio in determining repayment capacity. The debt-to-income ratio, which compares the borrower's income to their recurring monthly debts, is one of the indicators of whether the borrower will be able to repay the loan under its stated terms. Over the last 10 years, the overall proportion of household income devoted to debt service has steadily risen.

The debt-to-income ratio is the primary metric for measuring borrowers' ability to repay their increasingly heavy debt load. Establishing a rebuttable presumption of affordability based on a debt-to-income ratio of less than 50 percent will help ensure that borrowers will be able to afford their home loan payment. In addition, by permitting additional rulemaking regarding debt-to-income standards, the proposed legislation creates a mechanism for recognizing higher percentages in cases involving valid mitigating factors.

A clear bright line standard for determining repayment capacity, such as the debt-to-income ratio, will serve an especially important role by acting as a check on the significant portion of mortgage originators that are not subject to regular supervision. For depository institutions, regulators can evaluate whether the entity is complying with both the letter and spirit of provisions designed to address a borrower's ability to repay through the examination process, which includes loan level review and analysis. In the absence of ongoing supervision, there is a greater need for a clear, bright line standard to prevent efforts to subvert the ability to repay requirement.

The debt-to-income ratio will reinforce the benefits of requiring that loans be underwritten at the fully indexed interest rate. Without a debt-to-income limitation, lenders could underwrite loans to the fully indexed interest rate but at such a high percentage of a borrower's income that the loan could not realistically be repaid. The requirement that loans be fully documented also could be circumvented without a debt-to-income standard to ensure that the borrower's fully documented income can support the loan.

Although the bill does not directly address the kind of marketing disclosures I suggest above, it does include provisions requiring mortgage originators to disclose the comparative costs and benefits of mortgage loan products, the nature of the originator's relationship to the consumer, and any conflicts of interest that the originator may have. Providing this important information to consumers will empower them to make better informed decisions about the products and services being offered by mortgage originators. In addition, consumers will benefit from the prohibitions against steering a consumer to a mortgage loan that is not in the consumer's interest and against originators' receipt of incentive compensation, including yield spread premiums, based on the terms of a mortgage loan.

Finally, it is important to address assignee liability as a meaningful check on abuse by originators. Many mortgage originators are not subject to comprehensive supervision and assignee liability can provide an extra element of protection against abusive practices. Given the difficulties inherent in enforcing standards against originators, it is appropriate that those funding their activities bear some measure of responsibility for compliance with lending requirements. To be effective, however, assignee liability must be based on bright line standards so that assignees can effectively screen for noncompliance. Uncertainty regarding assignee responsibility could inadvertently dry up credit essential for responsible subprime lending.

Conclusion

As Congress moves forward on this bill and other legislation to address problems in the mortgage market, it is important that it take a balanced approach that preserves the elements of the current system that have worked well for the economy while ensuring that proven industry standards are used by all lenders. This approach will help not only borrowers. Investors and those who provide funding to the mortgage markets will benefit as well. I support the operation of market forces; however, it is appropriate to set rules for market participation. Moreover, price competition does not work if consumers do not understand the true cost of financial products. Through appropriate rulemaking and legislation, regulators and Congress can establish consumer protections that are strong and consistent across industry and regulatory lines. The FDIC stands ready to work with Congress to ensure that credit is based on standards that achieve a fair result for both the borrower and the lender.

That concludes my testimony. I would be happy to answer any questions the Committee might have.

NCLR
NATIONAL COUNCIL OF LA RAZA

Legislative Responses to Predatory Lending in Latino Communities

Presented at:

Legislative Proposals on Reforming Mortgage Practices

Submitted to:

U.S. House Committee on Financial Services

Submitted by:

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October 24, 2007

My name is Janis Bowdler, Senior Housing Policy Analyst on at the National Council of La Raza (NCLR). At NCLR, I direct research, policy analysis, and advocacy on affordable homeownership, and provide technical assistance to NCLR housing counseling grantees. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. During my time at NCLR, I have published a number of papers on the subject of predatory mortgage lending, including *Saving Homes, Saving Communities: Latino Brokers Speak Out on Hispanic Homeownership* and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. In addition, I have provided expert testimony before Congress and regulators on numerous occasions, recently before the House Financial Services Subcommittee on Housing and Community Opportunity, the Senate Banking, Housing, and Urban Affairs Committee, and before the Board of Governors of the Federal Reserve.

I would like to thank Chairman Frank and Ranking Member Bachus for inviting NCLR to testify today. NCLR strongly believes that the mortgage market does not work well for Latino borrowers. Like all Americans, Latinos rely on homeownership to provide financial security for their families and build long-term wealth. But research suggests that one in twelve Latinos with mortgage loans may now go into foreclosure. For this reason, action by the Congress and regulators is timely and urgently needed. We applaud Chairman Frank and committee members for taking steps to address predatory mortgage lending and restore confidence in the U.S. housing market.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Owner Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, increasing access to financial services among low-income people, and promoting homeownership in the Latino community. In addition to its policy and research work, as a sponsor of housing counseling agencies NCLR has been helping Latino families become homeowners for nearly ten years as a sponsor of housing counseling agencies. The NCLR Homeownership Network (NHN) works with 20,000 families annually, nearly 3,000 of whom become homeowners. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided $400 million in financing for locally-based development projects throughout the country, building the capacity of local nonprofits and creating opportunities for Latino communities. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market.

As detailed below, Chairman Frank, Congressman Miller, and Congressman Watt have produced a bill that includes a number of provisions that directly address the concerns of the Latino community.

Protecting Borrowers

As detailed in our reports and papers, NCLR has documented the flaws in the mortgage market that result in too many Latino and immigrant borrowers paying more than they should for their mortgage loan.[1] Unique borrower characteristics (i.e., thin credit files or a limited credit history, multiple wage earners in a household, and extensive use of cash income) for Latino and immigrant borrowers require more time and resources for mortgage lenders to serve appropriately. Many Latino families have been steered toward mortgage loans that have been easy to underwrite and profitable for originator but expensive and risky for the borrower. As a result, we are experiencing record-high foreclosure rates with market forecasters predicting these rates will increase well into 2008.

Mr. and Ms. Silva are just one of the thousands of families that have sought assistance from NHN housing counselors. The Silvas had good incomes and credit histories. They bought a home in Lawrence, Massachusetts for $380,000, which was at the top of their price range. The transaction included faulty title work and the home was poorly constructed. Moreover, the Silva's unknowingly were saddled with an unaffordable mortgage package. They received an "80/20" package – two loans, one for 80% of the purchase price, the other for 20%, as a way to finance 100% of the purchase price. The first loan was an Interest Only 2/6 Adjustable Rate Mortgage (ARM), meaning that the loan would be fixed for the first two years and then adjusts every six months. Under the impression that they were receiving a fixed rate loan, the Silvas believed their monthly payments would be manageable over time. However, they now face an unaffordable rate reset that may cause them to lose their home. When looking into their refinancing opportunities, they were told by area lenders that their home value was inflated at the time of the purchase and they now owe more than the value of their home. Their initial mortgage broker discouraged them from getting a home inspection, claiming "it was a waste of money for a new construction."

The homeownership counseling industry is being swamped with calls from borrowers seeking assistance in order to avoid foreclosure. Recent research from Moody's concluded that only 1% of eligible loans are being modified. Borrowers and counselors are calling NCLR to report that they or their clients cannot break away from their abusive loans.

The current environment suggests that the housing market is not correcting in a way that will help borrowers stay in their homes. Moreover, without improved consumer protections and greater system-wide accountability within the mortgage lending market, predatory lending will continue to persist and strip wealth and equity from Latino homeowners.

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[1] Bowdler, Janis and Tim Sandos, *Saving Homes, Saving Communities: Latino Brokers Speak Out on Hispanic Homeownership.* Washington, D.C. National Council of La Raza and National Association of Hispanic Real Estate Professionals, September, 2007; *Challenges to Building Sustainable Homeownership in Latino Communities,* presented by Janis Bowdler, National Council of La Raza, before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC, March 27, 2007; *Protecting Latino Wealth: Alternatives to Foreclosure,* presented by Janis Bowdler, National Council of La Raza, before the Committee on Financial Services, U.S. House of Representatives, Washington, DC, April 17, 2007; *Testimony on the Authority of the Federal Reserve under HOEPA,* presented by Janis Bowdler, National Council of La Raza, before the Federal Reserve, Washington, DC, June 14, 2007; *Testimony on the Impact of the Home Equity Lending Market on Latinos,* presented by Janis Bowdler, National Council of La Raza, before the Federal Reserve, Washington, DC, August 15, 2006; Bowdler, Janis, *Searching for the American Dream: Creating a Fair Housing System that Works for Latinos.* Washington DC: NCLR, May 2006; Goering, John, ed., *Fragile Rights within Cities: Government, Housing, and Fairness.* Lanham, Maryland: Rowman & Littlefield, 2007; Bowdler, Janis, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market.* Washington, DC: NCLR, March 2005.

Several provisions in H.R. 3915 would offer increased protections to all homeowners that may help to prevent in the future the type of abuse experienced by the Silvas.

- **Anti-steering provisions.** Two provisions within H.R. 3915 curb the practice of steering borrowers to unaffordable loans or those that are more expensive than warranted by a borrowers' credit risk. Many originators are paid premiums for adding prepayment penalties, increasing interest rates, including onerous and unnecessary terms, or for shifting borrowers to limited documentation loans (despite their ability to document their income). These premiums encourage steering unsuspecting borrowers, including many Latino and immigrant borrowers, toward risky and expensive products. The result is that many Hispanic homeowners waste hard-earned income on paying unnecessary fees and higher than reasonable interest when they should be paying off principal, building equity and wealth. Moreover, recent research shows that the risk of foreclosure increases with certain high-cost or risky mortgage products, leaving many Latino families even more vulnerable. As described in the story above, the Silvas face the possibility of going into default. The bill would eliminate compensation based on the terms of the borrower's mortgage, and prescribes regulations to be written by bank regulators to prohibit these practices.

- **Mortgage originator licensing system.** Most borrowers rely on mortgage professionals to coach them through the largest financial transaction they are likely to make in their lifetime. American families rely on professionals such as doctors, lawyers, accountants, and stockbrokers, all of whom have legal and ethical responsibilities to the consumer. Originators should be obliged to give consumers information they can trust. For many Latino homebuyers and owners who use mortgage brokers, transparency and accountability at the transaction level is critical. In fact, through a series of roundtables in partnership with the National Association of Hispanic Real Estate Professionals (NAHREP), NCLR was able to hear from brokers directly their desire to have strong licensing and accountability standards. H.R. 3915 moves in the right direction in this respect. It would regulate mortgage originators, including mortgage brokers, and create minimum licensing and regulatory standards for states to implement, preserving their ability to provide further protections. HUD would be required to craft rules designed to ensure that originators operating in states with scant regulatory protections declare on whose behalf they are working and operate in such a way as not to harm the borrower or the creditor. Under these rules, unregulated agents will be required act in the sole interest of the consumer. NCLR looks forward to working with the Committee to expand applicability of these standards. Had they been in place, these standards could have prevented the Silvas from being misled by their mortgage broker to forego an inspection and accept loan terms that were not favorable to their financial circumstances.

- **Ability-to-repay standard.** While many would consider it common sense to make loans a borrower can afford to repay, unaffordable loans are at the root of many abusive lending tactics. Teaser rates, deceptive advertising, and weak underwriting standards contribute to the making of loans that borrowers could never reasonably be expected to repay. H.R. 3915 sets forth guidelines for the federal banking agencies to regulate underwriting practices which will ensure that borrowers receive loans they can afford to repay. The standard makes it clear that the borrower's financial circumstances, including taxes, insurance, and other related costs, are factored into the determination of eligibility for a home loan. NHN housing counselors are working with thousands of families, like Mr. and Ms. Silva, who are facing foreclosure and who received loans that were never affordable in the first place.

The Mortgage Reform and Anti-Predatory Lending Act of 2007 includes other substantive protections for which the authors should be commended, including the limitation on prepayment penalties, the creation of a net tangible benefit, and additional protections for high-cost loans. In addition, NCLR would like to thank Chairman Frank, Congressman Miller, and Congressman Watt for not eroding strong protections available to some borrowers at the state level.

Recommendations

Strengthening H.R. 3915
While many of the protections set forth in H.R. 3915 are significant steps forward, key enforcement provisions must be strengthened in order for consumers to benefit from those protections.

- **Anti-steering enforcement.** The enforcement provision for the anti-steering section unnecessarily and arbitrarily caps the remedy to consumers available under the Truth in Lending Act (TILA) to three times the amount of direct or indirect compensation. Elsewhere in the bill the penalties under TILA are increased – provision NCLR supports. Thus, we believe those penalty provisions should apply equally here, without caps.

- **Assignee liability.** Generally speaking borrowers use their right of rescission to, in effect, cancel their bad loan while gaining the opportunity to refinance into a better loan. The right of rescission is expanded in this bill, including ensuring that a family that receives a loan that violates the terms of the legislation could defend their home in the case of a foreclosure. However, we are concerned that an exemption created in the bill would make it highly unlikely a consumer could return to the holder of their loan (the assignee) to exercise the right. Since most lenders sell their loans to Wall Street investors, borrowers like the Silvas often meet a dead end when they complain about their abusive loan to their original lender. To get their loan back, they must have access to the holder of the loan. The exemption would mean that the only way to access their loan holder and cancel their bad loan is to default on their mortgage and face foreclosure.[2] Given the obvious negative impact of foreclosure, this is an extremely undesirable and dangerous position for the consumer.

[2] The bill provides for limited liability against an assignees and securitizers that would allow consumers to rescind and collect reasonable costs associated with the violation and obtaining the rescission. Our concern lies in an exemption established for those that have a policy against buying certain kinds of loans (loans other than those defined in H.R. 3915 as "qualified mortgage" and a "qualified safe harbor mortgage") and that have representations and warranties from seller or assignor to this effect. Such an exemption could leave many borrowers without the ability to access the strongest remedy laid out in the bill, the right to rescind the loan.

- **Right of rescission.** H.R. 3915 would expand the right of rescission under TILA, as mentioned above. However, this right would be much stronger and more meaningful if it were generally connected to all harms committed under any provision of the bill and at any time within the statute of limitations, so long as a harmful violation can be demonstrated.

Additional Recommendations
NCLR looks forward to working with the authors of H.R. 3915, its cosponsors, and other members of this committee to continue to strengthen the bill. In addition to strengthening the enforcement provisions as described above, NCLR offers additional recommendations to enhance and complement the overall efforts of H.R. 3915.

- **Make loss mitigation mandatory.** Every homeowner deserves the right to loss mitigation services that may protect their investment and home equity. Servicers should be required to engage in reasonable efforts to prevent foreclosure by providing loss mitigation services. In addition, lenders and loan servicers should implement a streamlined, standardized approach and method for evaluating and modifying all loans that are delinquent, in foreclosure, or carry an adjustable rate. Legislation has been introduced in the House and in the Senate, which would push servicers to adopt improved loss mitigation tactics (see S. 1386).

- **Expand and strengthen the Community Reinvestment Act.** Research has shown that CRA has had a positive impact on affordable lending to underserved communities. Extending CRA lending obligations to all lenders creates an affirmative obligation to improve the quality of loan products available to low- and moderate-income borrowers and communities.

- **Invest in homeownership and foreclosure prevention counseling.** While many industry stakeholders have held increased education as a potential remedy for the lack of information in the marketplace, few are doing enough to support and strengthen the counseling industry. NCLR urges Congress and regulators to establish an incentive for investing in housing counseling. In addition, we applaud Congress and members of this committee for your continued support of the HUD Housing Counseling Program and urge appropriators to support the Senate's attempt increase funds available for this program given the anticipated rise in the number of families who need such services.

OPERATION HOPE

John Hope Bryant
Founder, Chairman and Chief Executive Officer
Operation HOPE

Testifying October 24th, 2007

Before the

U.S. House of Representatives

House Committee on Financial Services

Hearing on Legislative Proposals on Reforming Mortgage Practices

Thank you Committee Chairman Barney Frank, as well as the Members of the House Finance Committee, including Congresswoman Maxine Waters and Brad Sherman from California, Congresswoman Judy Biggert from Illinois, and the others, for calling today's hearing.

This hearing, focused on reviewing legislative proposals for reforming mortgage practices, in the light of the sub-prime crisis in America, is a critically important day for our country.

Let me start by saying that this is personal to me.

You see, my family lost our home in South Central Los Angeles, because he did not understand the documents he was signing, and because unfortunately, he asked the wrong question.

Growing up, I remember the pride I had, every week on Friday nights, watching my father make a payroll for his cement contracting business, from the front door of our home. That was powerful, for a son to see.

But after a while, the workers I knew so well would leave our home, and then a mortgage broker, someone I didn't know at all, would soon show up at the front door; finally convincing my otherwise brilliant father that he could somehow "have more," while simultaneously, somehow, "paying less," for now.

The result: my dad was left almost completely defenseless in making the most significant financial and wealth building decision of his adult life, and our family's life too.

A decision that in the end negatively impacted my dad, his marriage to my beautiful mother, who loved each other, but it was a marriage which ended, over money.

The number one cause for marriage today, is money. Ultimately, decisions made on that day in South Central L.A. had a negative ripple effect, years later, on my brother, my sister, my mother and me.

You see, my dad ultimately asked this person, this mortgage broker, the wrong question, asking "what's the payment," when in reality he should have been asking, "what's the interest rate?"

No one should ever ask what the payment is when there is an interest rate attached.

We lost our home not because my father wasn't brilliant, because he was, and is, at 83 years young today, but because my dad asked the wrong question, and then signed documents he didn't understand.

My mother's story, oddly enough, ended in a completely different way.

You see, my mom, who worked a regular 40-hour job, *was* financially literate.

My mother worked more than 35 years at McDonald Douglas Aircraft, now Boeing Aircraft, in Long Beach, California, and realized early on that "it was not necessarily about making more money, but making better decisions with the money you make."

My mother bought and sold 5 homes over time, and today she is retired and financially independent, living in Houston, Texas. In contrast, my dad is today financially *dependent*, living in a new 4-unit apartment building, built for him, by my wife and I; on the very street I grew up on in South Los Angeles.

Not all children, or even most children, are financially able to build and pay for a home for their father. Nor should they have too.

Parents should be in a position, if and when they can, to accumulate and later if they like, to pass down assets to their children, not the other way around. Some 20 years later, this is the negative legacy impact of the sub-prime mortgage crisis Americans, and not just low-wealth Americans, are experiencing today.

This is why I am so passionate about financial literacy, and economic empowerment today. It is personal to me.

As the founder, chairman and chief executive officer of Operation HOPE, inclusive of the only national delivery platform in urban, inner-city communities in the country for financial literacy education for youth, Banking on Our Future;

as well as the only national network of inner-city banking and empowerment centers located in urban, inner-city low-wealth communities, from California to Anacostia in Washington, D.C. to our latest HOPE Center in Harlem, New York, opened October 3rd, 2007;

and the nation's emergency economic disaster response program, a partnership with DHS/FEMA and DHS/Citizen Corps, respectfully asking you to take increased and immediate action around the growing sub-prime mortgage crisis in America.

With more than 250,000 low-wealth youth educated in financial literacy, the creation of more than 1,000 low wealth home owners and small business owners, and 85,000 individuals touched directly by our work in the aftermath of Hurricane Katrina, and thousands more served every year through our various on-the-ground and call-center offices, we have a fairly good sense of how individuals and communities are managing, or not managing, changes in our larger economy.

Within the context of this crisis, I can say without reservation that the answer here would be, not very well.

Just one example of this is our recently established Mortgage HOPE Crisis Hotline, a partnership between HOPE and City Council President Eric Garcetti of the City of Los Angeles, designed to help individuals in Southern California impacted by the sub-prime crisis.

When we launched phase I of the call center a couple of months ago we received 3,000 calls within the first 24 hours, and 4,000 calls within the first 2 days. To place this into context, we received an average of 3,000 calls monthly during our nationwide outreach initiative for Katrina victims. The 3,000 and 4,000 calls referenced here are for the Los Angeles area alone, and at the time, also mostly restricted to the Spanish speaking community of Los Angeles (initial media pick up was Spanish speaking media only).

We will soon roll-out phase II of our call center partnership with the City, and HOPE will partner with the State of California Banking and Finance Committee, around a similar State of California hearing on sub-prime and financial literacy, scheduled for November 1st, 2007, in South Los Angeles.

This said, respectfully, none of this, nor any other localized effort, will prove nearly enough to address this national problem.

Accordingly, I am proposing today, as I have likewise done this week in a letter to all federal financial regulatory agencies, that the federal government establish, possibly through the Federal Home Loan Bank System or other suitable agency, a $10 billion loan guarantee fund, structured in many ways like an SBA loan guarantee is.

Ideally, such a fund would be structured as follows:

1. Carry a standing fixed interest rate of 3%, allowing private lenders to add 2%-3% maximum, as a reasonable fee for administration, overhead and margin.

2. Allow anyone who had paid their loan on time and within terms of their agreement, prior to their rate reset, to be refinanced under this new program; the theory being that these individuals were already properly underwritten at the original term and rate, as there loans were performing within agreement at that time and during that period.

3. All new loans would be made at a 5-6% fixed rate, over a 30 year, and in some unique hardship cases, possibly a 40-year term.

Note A: This approach has the added benefit of adding a temporary economic stimulus into an otherwise stalling mortgage market and associated overall economy, as billion of dollars of effectively "new" money, and responsible mortgage loans, would be made over the next 18 months

Note B: This approach could serve as a unique and new opportunity for the credit union industry, as credit unions (1) were not substantially involved in the original problem, (2) several increasingly have the size and economic strength to make an impact if they decided to act, and (3) because of their unique tax structure, can afford to make these loans at an even lower price-point, making this win/win for all involved; new profitable business for credit unions, and a reasonable, rational and affordable exit plan for sub-prime borrowers in need.

Note C: On a separate future note, and as I have said recently on National Public Radio, will say today, and will respectfully repeat, as often as I can in town halls across America, <u>there is nothing wrong, and everything right, with responsible sub-prime lending</u>.

Going forward here, in fact, *responsible* sub-prime lending has done more to lift the poor out of poverty and into homeownership, asset accumulation, and in becoming a stakeholder in America, than anything else over the last 50 years.

<u>We want responsible sub-prime lending to the poor and working class in America to continue, post crisis.</u>

We do not want the source of funds to dry up, because of the reckless and unethical business practices of a few companies, and a number of predators.

The problem here is *irresponsible sub-prime lending*, predatory lending, and over-arching all of this, massive levels of financial illiteracy, even amongst America's middle class.

Individuals who simply asked the wrong question; "what's the payment" versus "what's the interest rate."

In this regard, going forward, in addition to my support of Congresswoman Biggert's recent bill's on the sub-prime crisis (HR 1752, but particularly HR 3017 and HR 3019), I would also respectfully encourage you to look at the possibility of creating a new, responsible sub-prime mortgage lending model and standard.

A model and standard that considers practical financial literacy consultation, a fixed rate, and a new 40-year term (thus addressing the principle issue driving low teaser adjustable rate loans today, the overall affordability of regular mortgage payments), as key components to the approach.

Thank you once again for holding this hearing, as well as your consideration of my proposal for a HOPE-Free Enterprise Mortgage Loan Guarantee Fund.

With HOPE

Testimony of Michael D. Calhoun
Center for Responsible Lending

Before the U.S. House Committee on Financial Services
"Legislative Proposals on Reforming Market Practices"

October 24, 2007

Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for holding this hearing to focus on cleaning up the subprime market and restoring confidence in home lending. Families all over the country continue to lose their homes in record numbers, stripping families of their wealth and destroying entire neighborhoods. At the same time, this massive wave of foreclosures has caused major disturbances in national and international markets as lending businesses shut down and thousands of people lose their jobs.

Policymakers in Congress have a long, proud history of taking action to protect the benefits of homeownership. The legislation under review today continues on that path in many ways. We commend the Chairman for his leadership and we hope this committee will endorse strong substantive protections against abusive and reckless lending and support those protections with effective remedies and enforcement.

In my testimony today, I would like to make five key points:

1) The current epidemic of subprime foreclosures is severe and widespread. The primary victims are hard-working families who, instead of gaining the benefits of homeownership, are struggling to keep their home.

2) Abusive loan products, reckless lending, and lack of accountability have caused the current credit crunch. If sensible limitations had been in place, the mortgage meltdown could have been avoided.

3) The market is not correcting itself. Incentives to make bad loans remain firmly in place. All evidence indicates a lack of self-correction, including recent reports on investment securities backed by subprime mortgages.

4) More disclosures as part of an already confusing and paper-heavy mortgage settlement process will not correct the problem.

5) The legislation proposed by Congressmen Frank, Miller and Watt could make a significant difference in preventing the abusive and reckless lending practices that contributed to today's foreclosure crisis. But a lack of adequate remedies for victims of predatory lending and insufficient means for enforcing the law could undermine key protections that would prevent foreclosures in the future.

Before elaborating on our main points, I will provide some brief background. I serve as the President of the Center for Responsible Lending (CRL) (www.responsiblelending.org). CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

We also have direct experience as a subprime lender. CRL is an affiliate of the Center for Community Self Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families, those often targeted for subprime loans. Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country. Our loan losses have been less than one percent per year.

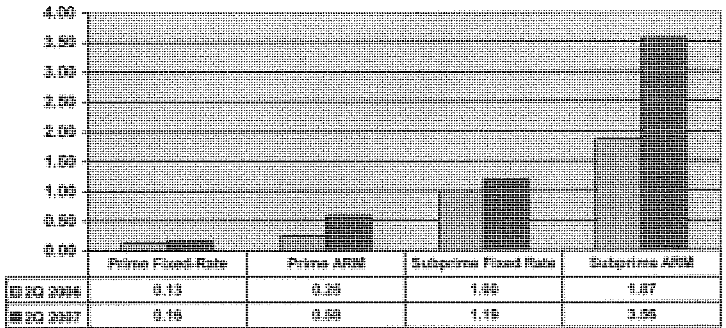
Through this lending experience, I understand the benefits of subprime loans that contribute to sustainable homeownership. Unfortunately, when it comes to fair, affordable mortgages and opportunities for lasting homeownership, the subprime market's record is sorely lacking. The Center for Responsible Lending estimates that 2.2 million families have lost or will lose their homes as a result of abusive subprime loans made in recent years.[1] That is one in every five subprime loans made in 2005 and 2006, a rate unseen in the modern mortgage market. When we consider the subsequent loans subprime borrowers have been refinanced into, the probable foreclosure rate jumps to over one third of all subprime borrowers.

I. Subprime foreclosures: their severity, impact and the misaligned incentives that exacerbate them.

A. The foreclosure problem is severe.

Every credible quantification of subprime foreclosures reveals that the problem is severe. The 2nd Quarter National Delinquency Survey by the Mortgage Bankers Association (MBA) shows that foreclosures on all types of loans have increased, but, as expected, foreclosures in the subprime market are most severe. New foreclosures on subprime adjustable-rate loans in the second quarter 2007 were **90%** higher than the same time last year, compared with a 23% increase on prime fixed-rate loans.

% Foreclosures Started During Quarter



Source: MBA National Delinquency Survey

At the same time, the MBA's "point in time" foreclosure statistics mask the extent of the foreclosure problem, because their figures fail to include the high number of subprime loans that were originated recently and have yet to enter their peak foreclosure years. CRL issued a study in December 2006 ("Losing Ground"[2]) estimating that **one out of every five subprime mortgages made in 2005 and 2006 ultimately will end in foreclosure.** This projection refers to actual homes lost, not late payments or foreclosures started but not completed.

When we released our report on subprime foreclosures, the lending industry claimed that our findings were overly pessimistic, and even today some in the industry continue to minimize the problem. However, as shown here, CRL's estimate is in line with other credible projections:[3]

	Loans Analyzed	# Loans in Analysis	Projected Foreclosure Rate (homes lost in foreclosure)	# Projected Foreclosures
MBA	Not disclosed	Not disclosed	Not disclosed	250,000
CRL	Subprime loans, owner-occupied properties, 2005 & 3Qs 2006	5,800,000	19.4%	1,125,000
First American Real Estate Solutions	All adjustable rate mortgages issued in 2004 & 2005[4]	7,700,000	14.3%	1,100,000
Lehman Brothers	Subprime loans, 2006 vintage only[5]	4,000,000[6]	30%	1,200,000
Moody's Economy.com	All loans[7]	Not disclosed	Not disclosed	1,700,000

By any measure, these estimates represent an epidemic of home losses. These foreclosures will not only harm the families who directly lose their homes, but the ripple effects have already begun to extend to the wider local, national and international communities.

B. The foreclosure problem is widespread.

The MBA's recent delinquency report also shows that mortgage loans entering foreclosure have increased in 47 states since this time last year. On average, the increases were 50% higher. Only four states—North Dakota, South Dakota, Utah and Wyoming—did not experience increases in new foreclosures. Less than two percent of the American population lives in those states.

When releasing the survey, the MBA downplayed new foreclosures by focusing only on changes between the last two quarters. But any minor changes from one quarter to the next are largely meaningless. **The foreclosures occurring today are the worst they've been in at least 25 years**

The MBA has also been quick to claim that the performance of subprime loans is primarily a result of local economic conditions, not loan products or underwriting practices. In fact, it is not an either/or proposition. Local economic conditions can affect house prices appreciation and unemployment levels, which affect foreclosure rates. However, subprime loans have typically included features that are known to increase the rate of foreclosure. Economic studies and empirical research also have shown that the incidence of foreclosure escalates quickly due to "layered risk" factors (such as a combination of low down payments, high debt-to-income ratios, adjustable interest rates, etc.)—exactly the types of loans that have dominated the subprime market in recent years.

Furthermore, if local economic conditions were the dominant factor in subprime loan performance, then there would be little distinction between the performance of subprime loans and FHA loans, which are also aimed at riskier borrowers. However, the MBA's own statistics show subprime loans perform worse than FHA loans in the same market:

	% of Outstanding Loans in Foreclosure at End of 2Q 2007	
	Subprime	**FHA**
Northeast	5.76	2.42
North Central	8.76	3.45
South	4.50	1.76
West	4.40	1.23
United States	5.52	2.15
Source: MBA National Delinquency Survey, 2Q 2007		

The MBA also has claimed that defaults on non-owner occupied properties are the major driver for increased subprime foreclosures.[8] However, 88% of foreclosures are suffered by people living in their primary residence.[9] A higher rate of foreclosures on investor properties is not a new development—default risks have always been significantly higher for investor properties compared with owner-occupied homes.[10] We question why the MBA is surprised by this result, if lenders were making subprime loans with loose underwriting standards to this even-riskier class of borrower. Moreover, this type of lending did nothing to increase homeownership, and instead fueled speculative home-buying, short-term run-ups in house prices, and now increased foreclosures and falling home values that are hurting all the families in these neighborhoods.

C. Families and neighborhoods are suffering as a result.

This year, many stories have appeared in the media describing the hardships imposed on families facing foreclosure. Often people ask, "How did these people get into these loans into the first place?"

While the details vary in every situation, the scenario we hear again and again is that lenders assured families that they had the right loan and were doing the right thing. Any time a borrower raised a question about a loan's interest rate or scheduled rate increase, mortgage brokers routinely assured them, "Don't worry about it. You can refinance." If a person expressed concern about an expensive prepayment penalty, they received similar promises: "Don't worry, we'll waive the fee when you refinance." Today these promises mean nothing, since refinances are no longer available for many of these families. Yet, it's not surprising that families would rely on brokers and lenders as the experts in mortgage financing. At some point in every mortgage transaction, the borrower must be able to trust the lender. Clearly, the trust has been betrayed.

Earlier this month, an article in the *Los Angeles Times* profiled a California couple, John and Mona Breidenstein, the parents of two children, who spent many months desperately trying to work with Countrywide Financial Corporation to convert an adjustable-rate subprime mortgage into a fixed-rate mortgage. Following the typical pattern, their broker had told the Breidensteins they would be able to refinance before the interest rate went up. The Breidensteins anticipated the interest rate adjustment well in advance, but the lender showed no interest in helping them. The couple spent eight months contacting various people at Countrywide, desperately trying to work out an affordable loan. Until the *LA Times* ran the story, Countrywide refused to offer the couple any option other than selling their home.

On a case-by-case basis, these losses represent a personal catastrophe to the families involved, but the negative results extend far beyond individuals. Entire communities will suffer because of the declines in property values that come with nearby foreclosures. Foreclosures can quickly transform neighborhoods from aspiring, stable communities to rows of boarded-up houses that become a breeding ground for crime.[11]

The cost of the subprime problem extends far beyond lost homes and ruined neighborhoods with dropping property values. Over 100 mortgage lenders already have gone out of business and thousands of workers have lost their jobs. It's harder for mortgage lenders and firms in other business lines to get credit from once-burned, twice-shy investors. The stock market is increasingly volatile and the housing market is facing its first national decline since house prices started being measured in the 1950s. All these factors spell slower (or even negative) economic growth in the U.S and—with German banks worried about subprime loans made in Chicago—bleak prospects for help from players in other global financial markets.[12]

D. The secondary market lacks incentives to support sustainable homeownership.

The secondary market for subprime loans lies at the heart of today's mortgage meltdown. Back in the days when families went to their local savings and loan to get a mortgage and the thrift held that loan among its own investments, the interests of borrowers and lenders were perfectly aligned: if the borrower did not pay the mortgage, the lender did not make money. But the growth of the secondary market upset that core alignment of interests between lender and borrower by creating a system where each actor was compensated early in the loan transaction, often within the first month of the loan, thereby reducing the incentive to worry about how the borrower would fare later on.[13]

Independent mortgage brokers originate most subprime loans (at least 70%), and receive their compensation from a lender immediately upon brokering the loan. That lender turns around and sells the loan into the secondary market, where it is bundled together with other mortgages and sliced and diced into securities. These securities are then sold to investors, who retain the right to collect payments and enforce the mortgage terms, including foreclosing on the home if the borrower defaults.

As the subprime market grew, Wall Street wanted more and more of these loans offering higher-risk investments with potential for higher returns. The demand from Wall Street was so intense that it encouraged subprime lenders to abandon reasonable qualifying standards, to forget about standard documentation requirements, and to ignore whether borrowers could actually afford the loan. Lenders created new, dangerous loan products that appeared deceptively affordable to borrowers, and brokers pushed these products to earn high fees. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?"

Or as Alan Greenspan recently told Newsweek, "The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime-loan market would have been very significantly less than it is in size."[14] Wall Street rating agencies also turned a blind eye to the increasingly high volume of poorly underwritten, extremely dangerous loans included in mortgage investments. Paid by the securitizers to rate the tranches, the agencies overlooked loans that any experienced underwriter would have known were headed for foreclosure, giving an AAA rating to the majority of the tranches created.[15]

The result of this buck-passing was the market meltdown of this summer, which now seems to be continuing into the fall. One market watcher recently observed that "Anything securitized in 2007 has got to have the worst collateral performance of any trust I've seen in my life."[16]

The best way to re-align the interests of borrowers and lenders is for Congress to insist on meaningful assignee liability. Since most mortgage loans are sold on the secondary market, it is essential that secondary market liability create incentives for the market to police itself. When assignee liability exists, the borrower is allowed to pursue legal claims against the assignee when the loan transaction involves illegal actions or abusive terms. In the case of the mortgage market, strong assignee liability would mean that when investors purchase high-risk mortgages, with all the corresponding financial benefits, they also accept reasonable liability for when the mortgages prove to be abusive and harm homeowners.

If this legislation is passed without meaningful assignee liability, the impact of its substantive provisions will be dramatically decreased. The fact is, public enforcement can never be adequate: there is a shortage of resources to match against the millions of loans made to borrowers, and in some cases, a lack of will to take significant action. Investigations will inevitably be too slow for the homeowners who face foreclosure in the meantime, and while public enforcement can achieve some relief, it will rarely, if ever, be enough to make most individual borrowers whole. If the substantive provisions of this bill are to be enforced, it will be done because wronged borrowers are able to move against the holder of their loan, just as they would have been able to do when lenders held the mortgage for the life of the loan.

II. Abusive lending, not regulation, has led to tighter credit.

While the mortgage industry has argued for years that regulation of subprime lending would have the unintended consequence of restricting credit, it is now apparent that the recent credit crunch was a consequence of the lack of adequate regulation and the reckless lending that followed. If subprime lenders had been subject to reasonable rules—the kind of rules that responsible mortgage lenders have always followed—we wouldn't have the problems we're seeing today.

At Self-Help, we know that it is possible to structure subprime loans in such a way that homeowners have a high chance of achieving sustainable ownership. Unfortunately, that's not what most subprime lenders have done in recent years. In fact, they have done the opposite. Typical subprime mortgages have been refinances that include adjustable interest rates, prepayment penalties, and little or no documentation of the borrower's income.

In the "Losing Ground" study, we examined subprime mortgages made from 1998 through 2003 to assess the relationship between specific loan characteristics and the loan's performance. As shown in the chart below, the typical features on subprime mortgages are strongly linked with higher rates of foreclosure:

% Increase in Foreclosure Risk for Specific Loan Features by Annual Loan Cohort[17]

(Positive numbers indicate higher risk, after controlling for borrower credit scores)

	1998	1999	2000	2001	2002	2003
ARM vs. Fixed-Rate Loan	123.31***	86.03***	72.03***	61.80***	77.85***	117.11***
Balloon vs. Fixed-Rate Amortizing Loan	75.67***	51.77***	36.02***	21.66***	14.08*	85.92***
Loan with Prepayment Penalty vs. Loan with No Prepayment Penalty	70.4***	65.0***	52.4***	35.8***	25.8***	18.7***
Loan with No or Low Documentation vs. Full-Doc Loan	5.57**	19.02***	29.00***	25.75***	44.72***	63.69***
Purchase Money Loan vs. Refinance Loan	19.3***	20.7***	28.5***	37.9***	61.0***	102.0***

Confidence levels: * = 95%, ** = 99%, *** = 99.9%. Detailed results available upon request.

This table shows that, even after controlling for a homeowner's credit score, typical subprime loan products and terms increase the chance of loan failures. For example, on adjustable-rate mortgages compared with fixed-rate mortgages, the foreclosure rate was 62 – 123% higher. Loans with prepayment penalties carried a higher foreclosure risk ranging from 19% to 70%.

Some of these loan characteristics can work fine for homeowners when their lenders have carefully evaluated the loan's risk. For example, adjustable-interest rates are a reasonable option for families who reasonably expect a future increase in income. But in recent years, the subprime market became dominated by adjustable rate mortgages that allowed families no chance to sustain them: they were set only to go up, could not go down, and had such high margins (6% to 6.5%) over a cost of funds index (LIBOR) that they quickly jumped to highly unaffordable levels. Further, typical subprime loans included multiple higher-risk features that became even more lethal when packed together in one loan. The 2-28 subprime "exploding ARMs" comprised "nearly 80% of subprime originations in 2006."[18]

For the past decade, subprime lenders have been aggressively marketing these dangerous loans and touting the easy availability of mortgages. Wall Street firms provided false assurances they knew their business. Now, because of their actions, the market is tighter for everyone, and trust in American markets has been eroded across the globe.

III. The market is not self-correcting.

Despite the widespread assumption that the market has corrected itself, we have yet to see evidence that lenders have significantly changed their practices. Last week, Standard & Poor's announced that it had downgraded 1,713 classes of residential mortgage-backed securities (RMBS) backed by subprime and Alt-A mortgages issued in the first half of 2007.[19] Similarly, a recent market analysis by an investment management firm, FBR Capital Markets, notes that the default rate on loans included in RMBS increased dramatically between July and August this year.[20] For RMBS made up of adjustable-rate subprime loans, the default rate increased by 44% in August over the previous month, and even for securities with fixed-rate subprime loans, the increase was 36%. The FBR analysis is clear in blaming high default rates on lax underwriting practices, and the report notes that as of June 2007, "We find little difference between the salient risk characteristics of subprime loans originated in 2007 and 2006."[21]

Moreover, advertisements for dangerous loan products still abound. For example, click on the ubiquitous popup internet ad for LowerMyBills.com—it's the one with the dancing alien and other animated creatures—and you'll be given an opportunity for a "deep discount" on a loan – most likely, a payment option ARM. And Chevy Chase Bank recently sent a flyer to its brokers featuring the excited announcement, "Good New Travels Fast: Stated Income is Back!" Attached to that announcement are guidelines and a rate sheet that show not only is the bank still making stated income loans, but even retirees on fixed incomes can get them.[22]

The truth is, the subprime mortgage market as currently structured doesn't have adequate incentives to change its practices. To the contrary, as long as the subprime market continues running without adequate rules, brokers and lenders will continue to make any type of loan that Wall Street will buy. The market may tighten up temporarily, but with so much money at stake, future abuses are inevitable.

Common-sense protections would prevent this catastrophe from happening again. We need a combination of targeted substantive protections combined with effective remedies and strong enforcement provisions.

IV. Disclosures are inadequate.

Industry representatives have urged policymakers to focus their response on requiring lenders to make further written disclosures to consumers—adding to the mountain of papers whose real significance is often difficult for the average consumer to assess, and is frequently contradicted by the oral explanations and assurances provided by mortgage brokers and lenders.

This response is insufficient, and reflects an inadequate appreciation of the problem's causes and scope. The failure to assess the risks and consequences of current lending practices is what created the problem to begin with. It must not be repeated as Congress contemplates solutions.

A common fallacy is that borrowers consciously choose and accept the loan terms they get because they read and sign an array of disclosure documents during the loan closing. In fact, most terms on a standard mortgage contract are buried in pre-printed loan documents, and are dictated by the lender, not negotiated by consumers. Further, the documents outlining critical loan terms are typically only three to five documents out of dozens in a standard loan closing.6

As former MBA President Robert M. Couch has explained, "Consumers rarely use these forms and disclosures to compare prices or identify the terms of the transaction because, quite simply, they cannot understand what they read nor what they sign. In addition, the mandated forms lack reliable cost figures, a fact that impedes prospective borrowers from ascertaining true total cost."[23]

Other issues that hinder disclosure from being effective include the complexity of many mortgage products and the difficulty of comprehending many disclosure forms that are allegedly in "plain English." For example, according to the commonly used Flesch Readability Score, the Truth in Lending form disclosures are comparable to reading the Wall Street Journal or Harvard Business Review. In short, improved disclosures are not likely to help borrowers, and in some cases they may make the situation worse.

V. The proposed legislation provides many strong and crucial substantive provisions, but remedies should be improved.

H.R. 3915 takes a comprehensive approach to the reckless and abusive mortgage lending practices that contributed to today's foreclosure crisis. We welcome Chairman Frank's, Congressmen Miller and Watt, and other committee members' leadership in tackling these issues. As I noted earlier, it is now clear beyond all doubt that inadequate regulation poses a greater threat to access to *productive* credit than does sound regulation.

We welcome the expansion of the protections to the highest-cost segment of the market promised by the bill – the expansion of HOEPA protections in Title III of the bill. The enhanced provisions will bring to the national market the benefits of several states' experience since 1999 with improving HOEPA to better address evolving problems in the high cost market. HOEPA was somewhat successful in addressing the abuses it targeted in 1994, but the market did not stand still. Because HOEPA did not preempt state law, states were able to, and did, move to address many of the next generation of problems that appeared in the years following HOEPA's enactment. We know that these laws work, and work without impeding access to credit, because we have been able to study their impact. The evidence suggests that legitimate, honest competitors benefit from the law, as well as consumers.[24] It counters the effect of a "Gresham's Law," wherein bad lending drives out good lending. The result is a "win-win" for consumers and for an efficient, marketplace that operates with integrity. We believe that extending the benefit of those leading-edge states nationally through the enactment of Title III can only be a positive benefit all around.

Titles I and II of the proposed bill would bring badly needed reform to broader segments of the market than HOEPA covers. These are central to reforming practices that led to the recent crisis: the abandonment of basic, common sense underwriting practices and the perverse incentives in the market that encouraged risky, rather than responsible, lending. In their eagerness to simply originate more volume to feed a hungry Wall Street, market players at all stages of the process forgot basic business values. They forgot that it is a basic part of the lending business to evaluate whether the borrower can pay back the loan. And they forgot that it is a basic part of any business to match the product to the borrower's needs. No one would ever defend an electrician who, asked to wire a home for a dryer, put in a 110 instead of a 220 outlet. Yet today's foreclosure fires were fueled by equally reckless actions. Sadly, the market justified its conduct by false assertions that it was homeowners who "chose" the inappropriate, dangerous 110 wiring, and that clamping down on such electricians would limit the overall supply.

In Titles I and II, the bill addresses common subprime practices that have fueled subprime foreclosures. Key, vital reforms are included in the substantive provisions of the bill:

* It would prohibit yield spread premiums. This should eliminate the perverse incentive to place borrowers in higher-cost loans than they qualify for to maximize brokers' compensation.

* It would prohibit prepayment penalties in the subprime market, where they have acted as what we have called "the glue for steering." The link to steering arises because brokers typically can get paid more (a higher yield spread premium) to deliver a loan with a prepayment penalty to a creditor. The prepayment penalty then, puts the consumer between a rock and a hard place. It either locks the consumer into an expensive, troublesome loan, or forces them to pay a steep "exit tax" to get out of it.

* It aims to bring more common sense underwriting practices to the market, primarily the subprime ARM market segment.

* It aims to assure that loans are better matched to the needs and capacity of the borrowers.

* It provides significant other reforms, including a ban on pre-dispute binding mandatory arbitration, and a prohibition on financing credit insurance and related products.

* In addition, it provides some long-needed updating to Truth in Lending remedies generally, increasing the civil damages and permitting consumers to raise rescission as a defense to foreclosure after the three year cut-off.

Together, these welcome reforms address key market failures that brought us to this pass. We are strongly supportive of the direction these substantive reforms would take, as we will explain in this testimony. They are crucial to restoring common sense to an industry that lost its way.

We also are pleased that this bill does not contain explicit preemption provisions. Over the years, we have seen many states respond swiftly and effectively to the growth of predatory lending practices in their jurisdictions, and we believe that it is critical for states to continue to have the ability to respond to new challenges as they arise. There is a risk, however, that regulations issued by certain regulators envisioned by this proposal, such as the OCC and OTS, may be interpreted to preempt state laws as a result of the National Bank Act and the Homeowners Loan Act, independent of the explicit preemption standards in this law itself. We hope that the rule-making authority envisioned do not result in unintended preemption.[25]

We do, however, have serious concerns about whether the incentives for compliance with the reforms are adequate. Most neutral arbiters acknowledge that the massive meltdown was a result of the separation of actions and consequences all along the chain, with a resulting break down in accountability. That is to say, Wall Street is part of the problem. That means that it must be part of the solution. While in the past, some have argued that exposing the secondary market too much to potential liability would result in dried up credit for subprime borrowers, we now see that too little exposure made them too reckless – and that resulted in a much more widespread credit crunch than virtually anyone imagined. Consequently, Wall Street can no longer assure us that its own market discipline will suffice. There must be adequate accountability for it, too. We understand, of course, that a balance must be struck. Unlimited, uncertain liability would likely impede liquidity. The question is whether the legislation, as proposed, strikes that balance.

As the bill currently stands, we fear that the remedies and enforcement provisions may well not ensure that the protections are meaningful and that industry participants, including the secondary market, take the protections seriously.

A. The bill includes vitally important protections that are critical to restoring responsible underwriting and origination practices to the market.

1. Requiring a determination that the borrower has an ability to repay is a key step to avert a recurrence of today's crisis

We welcome the bill's proposal that would require more realistic underwriting standards. It would require qualifying borrowers at the fully-indexed rate for the loan, and would require that taxes and insurance (both homeowners insurance and any mortgage insurance) costs be included when assessing a borrower's ability to repay.

By the industry's own admission, underwriting standards in the subprime market have become extremely loose in recent years, and analysts have cited this laxness as a key driver in foreclosures. For example, lenders who have marketed 2/28s and other hybrid ARMs generally have not considered whether the homeowner will be able to pay when the loan's interest rate resets, setting the borrower up for failure. Subprime lenders' public disclosures indicate that most are qualifying borrowers at or near the initial start rate, even when it is clear from the terms of the loan that the interest rate will rise significantly even if interest rates in the economy stay constant, giving the borrower a much higher monthly payment. In fact, it is not uncommon for 2/28 mortgages to be originated with an interest rate four percentage points under the fully-indexed rate. For a loan with an eight percent start rate, a four-percentage point increase to twelve percent is tantamount to a 40 percent increase in the monthly principal and interest payment amount. As the lenders well know, virtually no subprime borrower can afford such an increase.

We note that, though captioned as a protection for "all home loans," the existence of safe harbors seems to mean that, functionally, this provision applies primarily to subprime ARM loans. That is a signal improvement, as it appears that the structural market failure was in those loans. However, by no means was reckless underwriting limited to that segment. Indeed, unaffordable fixed rate loans were all-too common among that segment of the market not fixated on the hybrid ARMs. For example, the Associates and Household loans, which were the subject of regulatory action by the FTC and the states, respectively, primarily involved fixed-rate subprime loans.

2. The proposal recognizes that verification and documentation is essential to assuring that the ability to pay requirement is meaningful.[26]

The bill further requires that the determination of ability to pay be based on "verified and documented information." The unwarranted, unnecessary, and widespread use of stated income, and lo- or no-doc loans facilitated the epidemic of unsustainable lending. Lenders may evaluate the risk of a loan before approving it, but without adequate documentation of income, a lender's approval of a loan is meaningless. Even as the problem became undeniable, too many loans continued to be made on this basis into 2007. Based on our review of 10 mortgage-backed securities, we find that, on average, more than one third--37%--of these recently securitized subprime loans were approved based on stated income or reduced documentation standards for verifying the borrower's income.[27] The vast majority of borrowers have readily documentable W-2 income; by putting them in low-doc loans, lenders are either charging them up to 1 percent higher interest for no reason, or inventing non-existent income in order to make them a loan that is doomed to fail.

As Comptroller of the Currency, John Dugan, has stated, "Sound underwriting—and, for that matter—simple common sense—suggest that a mortgage lender would almost always want to verify the income of a riskier subprime borrower to make sure that he or she has the means to make the required monthly payment. Most subprime borrowers are salaried employees for whom verifying income by producing copies of W-2 forms is just not that difficult." We see no justification for lenders failing to use readily available data on a borrower's income, and are pleased that the bill recognizes this.

3. Requiring that originators serve the interests of their clients and customers is a lynchpin of market reform

The proposal would reverse an unfortunate trend in which originators lost sight of the basic purpose of their business – to provide their clients and customers with a loan product geared to their needs, and that they could sustain. Buying or refinancing a home is the biggest investment that most families ever make, and particularly in the subprime market, this transaction is often decisive in determining a family's future financial security. A broker has specialized market knowledge that the borrower relies on. Indeed, brokers hold themselves out to borrowers as a trusted adviser for navigating the complex mortgage market; that is the service they sell, and it is the service consumers assume they are buying.

Yet, mortgage brokers, for the most part, deny that they have any legal or ethical responsibility to refrain from selling inappropriate, unaffordable loans, or to avoid benefiting personally at the expense of their borrowers. Brokers and lenders have been too focused on feeding investor demand in exchange for high fees, regardless of how particular products affect individual homeowners. Moreover, because of the way they are compensated, brokers have strong incentives to sell excessively expensive loans

Experts on mortgage financing have long raised concerns about problems inherent in a market dominated by broker originations. For example, the chairman of the Federal Reserve Board, Ben S. Bernanke, recently noted that placing significant pricing discretion in the hands of financially motivated mortgage brokers in the sales of mortgage products can be a prescription for trouble, as it can lead to behavior not in compliance with fair lending laws. Similarly, a report issued by Harvard University's Joint Center for Housing Studies, stated, "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest rates the market will bear."

We welcome the bill's intent to establish a floor for the duties that originators must observe in dealing with their customers. Like the electrician, mortgage brokers' value lie in their specialized knowledge of a highly complex world. Their job is to help people less familiar with that world navigate it. Trust – *earned* trust – is essential to make that front-end segment of the market work. These reforms, properly implemented, will preclude brokers from denying that they must act responsibly toward their customers.

4. The anti-steering provisions take aim at one of the most insidious of market abuses – the discriminatory practice of steering families into unnecessarily expensive home loans, and it eliminates the perverse market incentives that encouraged it. The prohibition against yield spread premiums is among the most significant reforms proposed.

The bill takes on steering both directly, by mandating rules that will prohibit it, and by removing the perverse compensation incentive that encouraged it. We believe that the prohibition on yield spread premiums is one of the most significant reforms proposed, and we commend the bill's sponsors for tackling the problem head-on. The bill would eliminate this perverse market incentive, so that brokers would not maximize their own compensation by increasing both cost and risk to their clients.

Efficient financial markets should provide equally qualified borrowers with equally competitive prices on subprime home loans. However, both quantitative research and anecdotal evidence suggests that there are significant price disparities in subprime lending that indicate that some borrowers, particularly African-American and Latino families, pay more than necessary for subprime mortgages.

In May 2006, CRL analyzed data submitted by mortgage lenders for loans made in 2004 to assess the effects of race and ethnicity on pricing in the subprime market while controlling for the major risk factors used to determine loan prices. Our findings showed that, for most types of subprime home loans, African-American and Latino families were at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. In other words, if two families received subprime loans, one African American and one white, and they had the same credit score and were similarly qualified in every other way, the African-American family has a significant chance of receiving a higher-cost loan.

We welcome this effort to eliminate this practice that has caused so much wealth to be lost from so many families and communities.

5. Requiring a net tangible benefit for refinances will reduce equity stripping and stanch further loss of wealth.

The proposed legislation would incorporate some of the state reforms aimed at assuring that loans served a purpose other than transferring equity from the homeowner to the lender. Requiring that refinance loans provide a net tangible benefit to consumers extends to the entire nation the benefits of state laws that have proven effective. Loan flipping has, since the beginning of the subprime market, been a prime tool for stripping the equity from homeowners. Not only are they effective in curbing the practice, but they have not resulted in reduced access to legitimate credit.[28]

6. The elimination of prepayment penalties in the subprime market removes the "exit tax" for borrowers seeking to refinance to better terms, and complements the prohibition on yield spread premiums.

The proposal would prohibit prepayment penalties in the subprime market, where they have been a linchpin of market abuses. Eliminating them would eliminate another of the perverse incentives in the subprime market.

Prepayment penalties are an unfair practice in the subprime market because they have provided no net economic benefit to consumers. Not only are prepayment penalties expensive, but they also significantly increase the possibility that a homeowner will face foreclosure. Industry representatives often claim that borrowers receive a reduction in interest rates in exchange for prepayment penalties, but in the subprime market, this is not typically the case. According to quantitative research conducted by CRL, not only do prepayment penalties lock borrowers into higher-cost loans or force them to give up the wealth they have built through homeownership, but they also offer no benefit in the form of lower interest rates.[29]

This finding is often confirmed in subprime rate sheets that lenders distribute to brokers to give up-to-date information on loan pricing. These same rate sheets show that brokers receive a "yield-spread premium" for charging a higher interest rate than the borrower qualifies for on mortgages, often only if the broker convinces the borrower also to accept a prepayment penalty. In this way, even if there is a nominal reduction in the interest rate due to the prepayment penalty, this is offset or more than offset by the higher rate due to the yield- spread premium. Then, once borrowers receive the loan, they are faced with the Hobbesian choice of remaining stuck in it and paying excess interest each year, or of getting out of the loan and forfeiting significant amounts of family wealth as a result. This situation has become more serious for families as property appreciation has slowed down in many areas of the country.

By prohibiting yield spread premiums generally, and prohibiting prepayment penalties in the subprime market, the bill would break the bonds of the glue that links prepayment penalties to steering.

B. The proposal addresses additional long-standing problems in the market.

1. The prohibition against mandatory arbitration on any residential mortgage loans opens the door to transparent, neutral avenues for relief.

The proposal restores arbitration to its proper place. It cannot be imposed in a contract of adhesion to close the door to the courthouse for consumers, yet it remains an option where both parties choose to resolve a dispute after it has arisen.

Many lenders have favored placing pre-dispute, mandatory binding arbitration clauses in their loan contracts, although, since Fannie Mae and Freddie Mac adopted a policy refusing to buy loans that included mandatory arbitration, this practice has decreased somewhat. Mandatory arbitration imposes high costs on consumers in terms of filing fees and the costs of arbitration proceedings.[30] But arbitration also imposes more harmful costs on consumer-lender disputes by limiting the availability of counsel, cutting off traditional procedural protections such as rules of discovery and evidence, slowing dispute resolution, and restricting judicial review.[31]

Lenders, the "repeat players" in arbitration, benefit unfairly from that status. In some cases, lenders have used the mandatory arbitration clause to designate an arbiter within the industry, producing biased decisions. Lenders also are able to use arbitration to handle disputes in secret, avoiding open and public trials which would expose unfair lending practices to the public at large.[32]

This situation has only been made worse as many mandatory arbitration clauses have been expanded to also contain provisions that waive the consumers' right to participate in class action suits against the lender, making it more difficult for smaller claims to prevail. For these reasons, mandatory arbitration clauses are unfair to consumers who have no choice but to sign adhesion contracts.

2. Firmly closing the door on the use of credit insurance products will prevent a resurgence of a favorite equity-stripping tool.

Again incorporating the experience from the state laboratories for reform, the proposal prohibits the financing of single-premium credit insurance. It further assures that new variants, such as "debt suspension" agreements, are not used to evade restrictions on credit insurance.

3. The expanded scope and protections to HOEPA will give much needed new protections to the highest-cost mortgage market.

As we noted earlier, these amendments to HOEPA are necessary responses to a market segment that has evolved significantly in the 13 years since HOEPA was enacted. We know these reforms work, as they build on the experiences of states.

Together with the other provisions of the bill, we believe that new standards applicable to all segments of the home mortgage market would be positive for homeowners, the communities they live in, the industry, and the economy. In substance, the reforms are a positive step forward.

C. The proposed remedies should be improved to assure both sufficient incentives for the market to fully comply with the reforms and to assure that consumers have the ability to vindicate their rights.

It is critical that the important reforms described above take deep root and change market behavior. We now know that they are critical for the protection of consumers, but for their neighbors, for their communities, for investors, and for the economy as a whole. This is a key piece of restoring trust in the market – a trust that has been shaken at home and abroad.

We fear, however, that there are insufficient remedies for consumers affected by violations of the law, and that there may be insufficient disincentives in the bill to effectuate the necessary change in market behavior.

1. Violations of the originators' duties, including the anti-steering provision, would leave the consumer in unsuitable, inappropriate, or unnecessarily costly loans.

The remedy for violations of the provisions established in Title I – the originators' duty of care, and the anti-steering provisions – is limited to Truth in Lending damages (as amended in this bill), up to a maximum of three times the originator's compensation.[33]

The damages claims may be difficult to pursue. These limited damages would be available against the originator. Unfortunately, many originators are thinly capitalized, or often do not remain in business long. While the bill would set up minimum bonding requirements of $100,000, in today's mortgage market that would quickly be eaten up. While the first dozen victims of a broker might recover, the next victim may well be out of luck. Further, as we mentioned above, over 100 major originators in the past year have gone into bankruptcy, gone out of business, or disappeared into other entities,[34] leaving it difficult, if not virtually impossible for the consumer to pursue the claim against the originator.

As we interpret the bill, possibly this violation could be asserted against an assignee only where the violation is "apparent on the face of the documents," although that is not clear.[35] (As the bill is drafted, it is unclear whether this general rule would apply at all to claims against originators who were not also "creditors" as TIL defines that term.) We are uncertain as to the value of the claim for damages for a violation of the anti-steering provision when the homeowner is trying to raise the violation in any way other than a separate lawsuit against the originator. Can it be raised against the holder of the mortgage, with damages to be credited against the loan balance? If so, can that be done as an affirmative claim? Or can it be raised only in response to impending foreclosure?

Given the difficulty of obtaining a judgment against a broker and collecting on it, we believe that it is imperative that the consumer be able, at a minimum, to be able to apply the benefit of the claim to the outstanding obligation. This would not expose the secondary market to unreasonable liability.

More critically, the consumer is left to live with the terms of the unsuitable, inappropriate, or most costly loan. Consider the situation of a borrower placed into a 9% fixed rate subprime loan for $150,000 by a broker who receives a total compensation equaling three percent, or $4500, though she would have qualified for a 30-year fixed rate prime loan at 6.5%. Her maximum damages are $13,500. Yet she still has that 9% loan. Over the full life of the loan, she would pay unnecessarily an extra $136,308 – more than 10 times the damages she received. Even if she were able to refinance at five years, the loss to her caused by the steering would be over $28,000 – more than double her damages under this proposal.[36]

To assure that that there are adequate incentives for compliance with the badly needed reforms in Title I throughout the market, and to assure that consumers get the benefit of the reform, we believe that it is necessary to add a reformation remedy, which allows the consumer to reform the terms of the loan *ab initio* to one that would have complied with the requirements of Title I.

2. The remedies for violations of the ability to pay and the net tangible benefit provisions are a good start, but need improvement.

As we understand the remedies available for violations of the provisions mandating the ability to pay and net tangible benefit, there's a "two-gate" system which consumers must be able to penetrate before obtaining relief. As we read the legislation, it would work this way:
There is an "outer gate" that the consumer must unlock -- the ""qualified safe harbor mortgage."[37]

A subprime loan is a "qualified safe harbor mortgage" when it:

* meets **either** of two core requirements:

    - fixed payments for minimum of seven years, **or**

    - in the case of an adjustable rate loan, the margin is less than 3% over a recognized index,

* **and** meets all five additional requirements: a) income and resources are documented and verified; b) underwriting is based on a fully-indexed rate and takes all insurances and taxes into account; c) results in a DTI of 50% or less, or other standards to be set by regulation; d) is not negatively amortizing, and e) meets other requirements set by regulation.

The impact of the fixed payment prong, it appears is that these requirements, for all practical purposes, will apply primarily to subprime adjustable rate mortgages. (As we noted above, unaffordable and no-benefit fixed rate mortgages have also been common in the subprime.[38])

As we understand the process, if the loan falls within this safe harbor, the consumer could pursue a claim for a violation against the **creditor**, if he is able to rebut the presumption created by the fact that the loan is in that "safe harbor." If he does successfully rebut it, then the remedy against a creditor appears to be the civil monetary remedies generally available for violations of TIL under Section 1640. It is our understanding that the intent of the drafters was to also make the rescission remedy available, although, as drafted currently, violations of Title II would not trigger the rescission right at all. (We understand that this will be corrected.)

However, if the loan has been sold on the secondary market, as the majority of loans are today, the consumer has **no** right to pursue a claim against the **assignee, securitizer, or holder.** It is not clear if the consumer can even pursue this claim in defense of foreclosure. But certainly short of foreclosure, there is no way for the consumer to unlock the gate and raise a violation of these two provisions against an assignee in if the loan meets this "qualified safe harbor mortgage" status. Hence little meaningful relief would be available to a consumer before losing the house, despite a violation of the law.

If the loan does not fall within the qualified safe harbor, the consumer is then confronted with a second locked gate. An assignee or securitizer is exempt from even limited liability if it meets a 3-pronged test: it has a policy in place of not buying loans that are not "qualified safe harbor mortgages" or subprime mortgages, exercises due diligence to make sure they do not, and obtains representations and warranties from the seller, then the consumer can do nothing but wait for foreclosure. An assignee or securitizer who cannot meet the test for exemption has a right to cure the loan.

If the consumer can get past those two separate gates, we understand that the remedy intended to be available against assignees or securitizers is rescission. However, the trust – the true owner of the loan at this stage – does not appear from the language to be considered an "assignee or securitizer – and so there is, in effect, yet another hurdle for the consumer. (The separation of trusts from "assignees" and securitizers will make the process very cumbersome.)

Ultimately, because of all these hurdles, the primary remedy for consumers whose loans have been sold on the secondary market will be the ability to raise violations of those provisions in defense to an impending foreclosure. Thus, only once foreclosure has been initiated can a consumer do anything to vindicate these rights where it counts – in connection with the loan itself. In other words, then and only then can the consumer assert Truth in Lending's rescission remedy. (Again, this assumes that the necessary technical corrections will be met. As released on October 22, this remedy would not be available at all.)

Unfortunately, this puts a consumer between a rock and a hard place: she must tempt a foreclosure, entailing the consequent reduction in her FICO score which is likely to follow her for years, and may even make it harder for her to effectuate her rescission remedy by impeding her ability to tender.

Finally, no class actions are permitted for these violations against any assignee. The bill prohibits class actions for violations of these provisions. As a practical matter, with this protection and the other liability caps in place, there is no need for additional insulation from liability for the secondary market, much less the extraordinarily high level of insulation offered by this bill.

Reckless underwriting is at the heart of the recent crisis, and was as much a creation of the secondary market as the originators. We believe that the secondary market has too much insulation in this proposal for it to have adequate incentive for change, and consumers have too little opportunity to vindicate their rights. Yet we do understand that unlimited, uncertain exposure may have adverse effects.

Here, too, the experience of the states should prove instructive. In states with assignee liability in the context of subprime mortgages, the secondary market has continued to function – so well, in fact, that in some states the origination and subsequent securitization of such mortgages rose after the passage of the legislation imposing the liability. This effect may be because borrowers feel more comfortable accepting such loans when they know that anti-predatory legislation is in effect and can be enforced by private actors.

Indeed, the recent crisis of confidence in the rating agencies much vaunted ability to rate risk may well do the same. Investors may feel more confident in the force of law than in the now tainted ratings by a self-interested and self-dealing market.

As we have more time to study the proposed bill in depth, we will be happy to work with you in an effort to find the proper calibration.

3. The proposal to increase the amount of TIL monetary damages and permit rescission after three years is welcome.

Civil monetary remedies for TIL violations as applied to mortgages have been capped at $2000, and $1000 for other loans, since the 1970's,[39] an amount insufficient either to provide adequate deterrence for non-compliance or adequate relief for consumers. An increase in these remedies is long overdue, and we appreciate the leadership of the committee in bringing updating this aspect of the law

Similarly, we appreciate the recognition in the bill that a consumer who faces foreclosure 37 months into a loan needs to be able to assert rescission just as much as one who faces foreclosure 35 months into a loan.

Conclusion

Historically, the best interests of financial institutions and homeowners were closely aligned. When a home foreclosed, it was a loss not only to the family who lived in the home, but also to the lender who had provided the loan. Today, particularly in the in the subprime market we have a disconnect between these interests, and that needs to change. To restore the world's confidence in our markets and recover a reasonable expectation of integrity to our mortgage financing system, we need decisive policy actions to realign the interests of people who buy homes and institutions that provide the loans and the entities that invest in those mortgages. As long as subprime lenders have little or no incentive to make a loan successful, we will continue to push families back financially, and rather than building our nation's prosperity through homeownership, we will continue to lose economic ground.

The subprime lending system has failed millions of middle-class families. These are people who were trying to do everything right: they worked hard at their jobs, they took care of their children, and they were seeking a more secure future. Now these families are on the verge of losing any semblance of security, and we all will be worse off as a result. As outlined here, policymakers have a number of tools at their disposal to mitigate the harm caused by this situation and prevent it from happening again in the future. We strongly urge you to consider our recommendations for making a strong bill even stronger.

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[1] Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners*, (December 2006) at http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=31214551.

[2] *Losing Ground,* note 1.

[3] In addition, see Bob Ivry, "Subprime Borrowers to Lose Homes at Record Pace as Rates Rise," Bloomberg.com (September 19, 2007).

[4] Christopher L. Cagan, *Mortgage Payment Reset: The Issue and the Impact, First American CoreLogic* (March 19, 2007), available at http://www.facorelogic.com/uploadedFiles/Newsroom/Studies_and_Briefs/Studies/20070048MortgagePaymentResetStudy_FINAL.pdf

[5] Mortgage Finance Industry Overview, Lehman Brothers Equity Research (December 22, 2006).

[6] Robert B. Avery, Kenneth P. Brevoort and Glenn B. Canner, "The 2006 HMDA Data," Federal Reserve Board (September 12, 2007), available at http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06draft.pdf.

[7] Moody's Economy.com, "Into the Woods: Mortgage Credit Quality, Its Prospects, and Implications," a study incorporating unique data from Equifax and Moody's Investors Service (2007).

[8] We are unable to verify the extent of this problem because the MBA used proprietary data to make this claim.

[9] Mortgage Bankers Association Press Release "Investor Loans Major Part of Defaults in States with Fastest Rising Delinquencies" 8/30/2007, at http://www.mbaa.org/NewsandMedia/PressCenter/56535.htm

[10] See, e.g., "HomeRefi Now," American Fidelity Mortgage at http://www.homerefinow.com/mortgage-info/investor_loans.asp ("The fact is that the default rate on small investor loans is significantly higher than that of their owner occupied counterparts...").

[11] Jim Rokakis, "The Shadow of Debt: Slavic Village is Fast Becoming a Ghost Town," *Washington Post* (September 30, 2007).

[12] See, e.g., Nicola Clark, "Bank in Germany Posts Loss Because of Bad Stock Trades," *New York Times* (August 31, 2007); Jenny Anderson and Heather Timmons, "Why a U.S. Subprime Mortgage Crisis is Felt Across the World," *New York Times* (August 31, 2007). Indeed, the globalization of the consequences has left people on other continents asking for an international oversight role: "Why should the rules of lending in the U.S. be left to U.S. regulators when the consequences go everywhere?" Heather Timmons and Katrin Bennhold, "Calls Grow for Foreigners to Have a Say in U.S. Market Rules," *New York Times* C1, (August 29, 2007).

[13] Chairman Bernanke makes this point in a recent presentation: "Housing, Housing Finance, and Monetary Policy, remarks by Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System at the Federal Reserve Bank of Kansas City's Economic Symposium – Jackson, Hole, Wyoming (August 31, 2007), pp. 16 – 17.

[14] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

[15] *See, e.g.* Allan Sloan, "An Unsavory Slice of Subprime," *Washington Post* (October 16, 2007) ("Even though individual loans ... looked like financial toxic waste," 68% of the issue was rated AAA.)

[16] Shannon D. Harrington and Mark Pittman, " Subprime Delinquencies Accelerating, Moody's Says," (October 5, 2007), available at http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=a8Mzhz09jHP8

[17] Losing Ground, note 1 at page 21.

[18] Credit Suisse, *Mortgage Liquidity du Jour: Underestimated No More,* (March 12, 2007) p. 6.

[19] "S&P downgrades 1,713 classes of mortgage-backed securities issued in the first half of 2007," Associated Press (October 17, 2007).

[20] FBR Capital Markets, "Structured Finance Insights," FBR Investment Management, Inc. (September 28, 2007).

[21] FBR Capital Markets, note 14 at p. 2.

[22] Copies on file with the Center for Responsible Lending.

[23] Robert Couch testimony before the U.S. House of Representatives Financial Services Subcommittee (November 2003), cited in "Financial Education: No Substitute for Predatory Lending Reform," Issue Paper No. 7, Center for Responsible Lending (September 13, 2004).

[24] *See* Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, Center for Responsible Lending (February 23, 2006).

[25] I will not discuss this issue in this testimony, but would welcome the opportunity to expand on it following this hearing.

[26] As with the ability to pay, though included in protections available for "all loans", the operations of the proposed two safe harbors would, for the most part, mean that this functionally applies primarily to subprime adjustable rate loans, as we read the bill.

[27] *See, e.g.* Testimony of Michael Calhoun, Before the US Senate Committee on Banking, Housing and Urban Affairs; Subc. on Transportation, Housing and Urban Affairs, *Ending Mortgage Abuse: Safeguarding Homebuyers*, Appx 1, (June 26, 2007), *available a t*http://www.responsiblelending.org/pdfs/senate-testimony-m-calhoun-june-26-2007.pdf.

[28] *See* Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, Center for Responsible Lending (February 23, 2006)

[29] Keith Ernst, "Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages ," Center for Responsible Lending (January 2005).

[30] *See* Victoria Nugent, *Arbitration Clauses that Require Individuals to Pay Excessive Fees are Unconscionable,* THE CONSUMER ADVOCATE 8, 9-10 (Sept./Oct. 1999).

[31] Paul D. Carrington and Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 346-9 (1996).

[32] *See* John Vail, *Defeating Mandatory Arbitration Clauses,* TRIAL 70 (Jan. 2000).

[33] The general TIL monetary damages include actual damages and statutory damages of $2000 for mortgage loans. Court interpretations, however, have recently made actual damages very difficult to win. *See generally* National Consumer Law Center, *Truth in Lending*,§ 8.5.4 (5th Ed. 2003). It is possible that violation of the duty, or of the steering requirement, will be more susceptible to actual damage awards by courts, but that remains to be seen if that is the test.

[34] A list was attached to the testimony of Martin Eakes before the Joint Economic Committee, pp. 28-41, (September 19, 2007.)

[35] As a general rule, except as otherwise specified, monetary remedies for violations of TIL's requirements can be brought against assignees only when the violation is "apparent on the face of the documents." 15 U.S.C. § 1641(a),(e). As the bill is drafted, it is unclear whether this general rule would apply at all to claims against originators. Indeed, it is unclear how this definition is intended to apply with respect to table-funded loans.

[36] During the first 60 months, the extra cost in monthly payments would be over $378, ($1206.93, compared to $828.30) for a total loss of nearly $22,800. The payoff balance after 60 months would be nearly $5600 more.

[37] We understand that the bill will be changed so that the prime loan "safe harbor" will no longer be a safe harbor. Instead, these two provisions will only apply to subprime loans in the first instance. This testimony assumes that change.

[38] Fixed rate mortgages were the standard first lien products for Household and Associates, both targets of public enforcement actions and much private litigation. Flipping and making loans with out regard to repayment ability was standard.

[39] 15 USC 1640(a)(2)(A)(i).

"Stated Income" Conforming Fixed Rate

Investor Code: 004
Loan Types: 151 (30 Year); 152 (15 Year)

GENERAL INFORMATION:

Maximum Loan Term: 30 Years

- Employment and income are stated on the 1003 but income is not verified. The applicant's income must not be documented **anywhere** in the loan file; otherwise, full/alt documentation is required. The applicant's 1003 must include the specific source(s) of income with a minimum of two years employment in the same line of work. For all self-employed applicants, the applicant's business must be in existence for at least two years.
- All assets must be listed on the 1003 and should be consistent with the stated income. The applicant must disclose liquid assets that are sufficient to cover funds needed to close the transaction.
- IRS Form 4506 must be signed by the borrowers at application and closing.
- All loans must receive an **"Approve/Eligible"** recommendation from Fannie Mae's Desktop Underwriter® ("DU®"). [SFCs for DU Approve/Eligible should not be delivered.]
- Applicants without credit scores are not eligible.

LOAN LIMITS:

Loan Amount – Conforming Limits				
Purchase or Limited Cash-Out Refinance				
Occupancy	**Units**	**LTV (%)**	**HCLTV (%)**	**Credit Score**
Primary	1	95	95	660
	2-4	95	95	680
	2-4	75	75	660
Second Home	1	90	90	660
Investment	1-4	90	90	700
	1-4	75	75	660

Loan Amount – Conforming Limits				
Cash-Out Refinance				
Occupancy	**Units**	**LTV (%)**	**HCLTV (%)**	**Credit Score**
Primary	1	90	90	680
	2-4	90	90	700
	1-4	75	75	660
Second Home	1	90	90	680
	1	75	75	660
Investment	1	90	90	720
	2-4	90	90	740
	1	75	75	660
	2-4	75	75	680
	2-4	60	60	660

SECONDARY FINANCING:

- Follow standard Fannie Mae guidelines.

REFINANCES:

- Follow standard Fannie Mae guidelines.
- Limited cash-out refinances may include the following:
  - the pay off of the outstanding principal balance of any existing first mortgage,
  - the pay off of the outstanding principal balance of any existing subordinate mortgage that was used in whole to acquire the subject property (document via HUD-1),
  - financing of closing costs and prepaids, and
  - cash back to the applicants in an amount not to exceed the lesser of 2% of the loan amount or $2000.
- Refinance mortgages that involve the pay off of subordinate liens that were not used in whole to purchase the subject property (including home improvement, HELOC and second mortgages obtained for the purpose of taking equity out of the property, even if a portion of the subordinate lien was used to purchase the property) will be considered a cash-out refinance.
- Texas properties are not eligible for a cash-out refinance.
- Proceeds from a cash-out refinance transaction cannot be used for business purposes.

SELLER CONTRIBUTIONS:

- Follow standard Fannie Mae guidelines.

TEMPORARY BUYDOWNS:

- Not Allowed

MORTGAGE INSURANCE:

- CCB's Lender Paid Mortgage Insurance (LPMI) cannot be used.
- Mortgage insurance is required on all loans with LTVs greater than 80% as follows:

LTV	Coverage
90.01%-95.00%	30%
85.01%-90.00%	25%
80.01%-85.00%	12%

- Loans are not eligible for Fannie Mae's "Reduced MI" or "Lower Cost MI" coverage, regardless of the DU recommendation.

APPRAISAL REQUIREMENTS:

- Appraisal Form 1004 is required, regardless of the DU recommendation.
- Appraisal updates or new appraisals are required as follows:

More than 120 days old	Over 12 months old
update	new

- Fannie Mae's "Property Inspection Waiver" cannot be used, regardless of the DU recommendation.

"Stated Income" Conforming Fixed Rate
Investor Code: 004
Loan Types: 151 (30 Year); 152 (15 Year)

PROPERTY REQUIREMENTS:

- Eligible properties:
  - Single Family Residence
  - Townhouse
  - 2-4 Unit
  - Condominium
  - PUD
- Manufactured housing, condohotels, time-share units, apartment conversions and cooperatives are not acceptable.
- Leasehold properties are acceptable per Fannie Mae guidelines.
- Properties located in the following states are not eligible:
  - Colorado
  - Minnesota
  - Nevada
  - Ohio

UNDERWRITING:

- Follow standard Fannie Mae guidelines unless otherwise noted.
- Salaried and self-employed applicants are eligible.
- A reasonable relationship must exist between all of the loan characteristics (i.e., field of employment, stated income, assets, and credit).
- Online sources that provide compensation data – such as "salary.com" or "CareerJournal.com" – should be used to validate stated income.
- All loans must receive an "Approve/Eligible" recommendation from DU.
- IRS Form 4506 must be signed by the borrowers at application and closing.
- Maximum qualifying debt-to-income ratio is 41%.
- Employment and income are stated on the 1003 but income is not verified. The applicant's income must not be documented **anywhere** in the loan file; otherwise, full/alt documentation is required. The applicant's 1003 must include the specific source(s) of income with a minimum of two years employment in the same line of work. For all self-employed applicants, the applicant's business must be in existence for at least two years.
- The applicant's employment/income source must be verified as follows:

Employment/Income Source	Acceptable Verification Sources
Salaried	Verbal VOE
Self-Employed	Business existence must be documented for all self-employed applicants through: • evidence of a business license; and • verbal confirmation of a phone directory listing. A signed confirmation of the business must be obtained from the applicant's accountant where a license is not required for the business.
Retirement **Social Security** **Annuity** **Trust**	▪ Awards Letter with income "blacked out"; **or** ▪ Verify annuity funds; **or** ▪ Letter from Trustee
Schedule B **Dividend & Interest Income**	▪ Verify assets supporting income; **or** ▪ Sch. B with income "blacked out"

- All assets must be listed on the 1003 and should be consistent with the income stated. Asset verification is required on all loans, regardless of the DU recommendation.
- The applicant must disclose liquid assets that are sufficient to cover funds needed to close the transaction. The funds to close must be verified according to Fannie Mae Selling Guide requirements.

- Refer to the "Loan Limits" section for the minimum credit score requirement.
- Applicants without credit scores are not eligible.
- Cash reserves are not required.
- Non-permanent resident aliens are acceptable per Fannie Mae guidelines.
- First-time homebuyers are eligible.
- Non-occupant co-borrowers are not acceptable.
- Second homes or investment properties – applicants may not own more than five (5) financed properties, including their primary residence.
- Special Feature Code (SFC): 442

Program Announcements

October 04, 2007

Good News Travels Fast

Stated Income is Back!

- Up to 75% LTV on Primary and Second Homes
- Loan Amounts up to $1.5 Million

Our Rates are Falling

LIBOR Drops to 5.129%

Now is a great time to choose our LIBOR Cashflow Option ARM

- Minimum Payment Rate as low as 1.00%
- 95% LTV to $700,000
- 90% LTV to $1 Million
- Earn up to 2.25% YSP
- Allow your borrowers to lock-in to a low minimum payment and capitalize on falling interest rates

2 Yr Prepay Now Available on the 1 Yr Cashflow Option ARM

- Choose between No, 1, 2, or 3 year prepay

For Release Upon Delivery
10:00 a.m., October 24, 2007

TESTIMONY OF

JOHN C. DUGAN

COMPTROLLER OF THE CURRENCY

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 24, 2007

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for the opportunity to testify on H.R.3915, the "Mortgage Reform and Anti-Predatory Lending Act of 2007." The OCC supports several key goals of the legislation, especially the establishment of national standards for subprime mortgages, which have been the source of so many recent problems in credit markets. We also support the bill's goal of enhanced regulation of all mortgage brokers, whether used by banks or nonbanks.

As the OCC and others have testified, the lower underwriting and sales practice standards at non-federally regulated mortgage providers were a significant cause of the subprime loan problems we face today. This is not to suggest that banks and their affiliates had no part in the current problems, although, as we have previously testified, national banks and their operating subsidiaries originated only about 10 percent of subprime loans issued in 2006, and the rates of default on these loans have been significantly lower than the national average. In recognition of pervasive problems in the subprime market generally, the federal banking agencies tightened mortgage standards by issuing the *Statement on Subprime Mortgage Lending*, which followed the previously issued *Interagency Guidance on Nontraditional Mortgage Risks*. We believe these federal banking agency standards addressed fundamental concerns about underwriting and marketing practices for subprime and nontraditional mortgages.

Of course, these standards apply only to federally regulated institutions. They do not and cannot address similar practices at state-regulated institutions that are not banks, even though, by nearly all accounts, such institutions engaged in some of the most aggressive mortgage practices. As a result, the federal banking agency standards cannot be truly effective unless they extend to non-federally regulated institutions as well, to create truly national standards. Such national standards could be achieved through state action, such as through uniform state legislation or rulemaking that adopts the federal banking agency standards, as has been done in some, but not all, of the states. They could also be largely achieved by regulation through Federal Reserve Board rulemaking under the Home Ownership and Equity Protection Act (HOEPA). Or they could be achieved through federal legislation, such as the bill that is the subject of today's hearing. Regardless of the path chosen, the OCC supports national standards for subprime mortgages that are similar to the federal banking agency standards.

From our initial understanding of the bill, which we have only had limited time to review, it intends to establish national mortgage standards for three different categories of mortgages.

- For all mortgages, the bill would establish national sales practice standards for "mortgage originators" through licensing and registration requirements, a federal duty of care, and anti-steering provisions. The bill would also prohibit single premium credit life insurance and mandatory arbitration for all mortgages, and would impose restrictions on all negative amortization mortgages provided to first time homebuyers.
- For subprime mortgages, the bill would – through the use of "safe harbor" provisions – establish national underwriting standards that are similar to, but more stringent than, the underwriting provisions in the federal banking agency standards.[1] These new national underwriting standards would be enforced through, among other mechanisms, creditor and assignee liability provisions. In

[1] While the safe harbor provisions focus the bill's underwriting restrictions to subprime mortgages, the underwriting provisions nominally apply to all mortgages and could affect prime loans in certain circumstances.

addition, the bill would prohibit prepayment penalties for all subprime mortgages.[2]

- For HOEPA mortgages, the bill would lower the APR and fee triggers and add additional categories of fees, including certain prepayment penalties, to count toward the fee triggers. These changes would make less costly mortgages subject to the enhanced HOEPA regulatory regime.

Taken together, these three categories of changes plainly go beyond the federal banking agency standards. That is, some of the new national standards apply to mortgages other than subprime mortgages, and some of the bill's national subprime standards are more stringent. While we support some of these broader standards, others raise significant questions and concerns that we hope will be addressed as the process moves forward.

In particular, the application of some of the new and extensive national mortgage standards to banks that do not provide subprime mortgages raises significant issues of regulatory burden and fairness. In addition, the more stringent standards for subprime mortgages would by definition restrict the availability of credit to subprime borrowers more than the federal banking agency standards. This would increase the likelihood that some creditworthy subprime borrowers would be denied credit, and would also make it more difficult for some existing subprime borrowers to refinance their loans. These and other concerns are addressed in more detail below, in more specific comments concerning the bill's provisions.

[2] The "subprime" restrictions in the bill would actually apply to all non-prime mortgages, including so-called "Alt-A" mortgages.

National Standards Applicable to All Mortgages

Licensing and Registration Requirements

The licensing and registration requirements respond to the need for better regulation of mortgage brokers. For example, the bill would impose new qualitative controls and net worth requirements on non-federally regulated mortgage brokers, including those used by banks. We support this aspect of the bill, which would fill a distinct regulatory void.

We also support the bill's establishment of a new system to track mortgage originators that have been subject to sanctions for their conduct, whether as bank employees or as independent mortgage originators. To ensure that information about "bad actors" is available to both federal and state regulators, the legislation directs the federal banking agencies, and state authorities, to submit information about formal enforcement actions against individuals to a new centralized national database. Such a system would be highly valuable to both federal and state regulators, as well as to lenders and prospective borrowers.

We do, however, have significant concerns about extending the licensing and registration provisions beyond brokers, who clearly need it, to every individual bank employee involved in mortgage origination, where the need is far less clear. In our view, the bill's one-size-fits-all standard for licensing and registering mortgage originators will impose substantial new compliance burdens on banks – especially community banks. We question whether the marginal benefits are worth these burdens, because banks and their employees (1) are already subject to supervision and federal standards, and (2) have not been the primary cause of recent mortgage problems.

That is, bank regulators conduct ongoing oversight of a bank's mortgage lending standards, operations, systems, and controls, as well as of bank employees engaged in mortgage lending. National banks are already required to adopt and implement appropriate internal controls and standards for all employees, including those engaged in loan originations. These internal controls include segregation of duties to reduce opportunities for fraud and concealment; prevention of conflicts of interest; safeguards on access to assets and records; documentation procedures; reporting; and reviews of compliance with bank policy. Special written procedures and controls are required for real estate lending functions. Our supervision periodically addresses whether the bank has implemented appropriate internal controls and safeguards for oversight of loan officers. And, the OCC takes enforcement actions to address violations of law, including fraud, by individuals engaged in loan origination functions at national banks and their operating subsidiaries.

This supervisory approach obviously cannot be used for nonbank mortgage originators. There, greater reliance *must* be placed on a screening and clearance process for entry by individuals into the business, because there is no comparable system of ongoing supervision.

The federal banking agency supervisory and enforcement approach would also extend to any new substantive mortgage requirements that Congress chooses to impose on banks, such as the federal duty of care or subprime underwriting standards required by H.R. 3915. As a result, a costly overlay of new and extensive licensing, registration, and compliance requirements for individual bank employees arguably would be unnecessary, especially for community banks that can least afford the additional compliance burden.

Duty of Care Standards

The OCC supports the part of the federal duty of care provision that requires full disclosure of key mortgage terms. We are concerned, however, about the part of the provision that requires originators to present borrowers with mortgages that are "appropriate" to the consumer's circumstances. While appealing in concept, the standard is quite subjective, and therefore could be very challenging to implement and enforce. We believe the provision should be clarified so that it is not interpreted to be a kind of *de facto* "suitability" standard that could expose lenders to substantial litigation risk even when acting in good faith. This might be accomplished by a linkage between the "appropriateness" determination and assessment of the borrower's ability to repay.

Indeed, based on extensive comments that we received when developing the federal banking agency standards, the agencies decided not to adopt a "suitability" standard. Instead, we opted to rely exclusively on an objective standard based on an assessment of a prospective borrower's ability to repay. Like Title II of the bill, the banking agency standard focuses on the borrower's ability to repay the loan according to its terms, based on the fully-indexed, fully-amortizing rate, and describes the factors lenders should consider in making that assessment.

Anti-Steering Provisions

The anti-steering provisions would prohibit certain incentive compensation. We fully understand the objectives of the bill in seeking to curtail yield spread premiums and similar broker inducements that have been severely criticized. We are concerned, however, about the breadth of the provision, which could have the unintended consequence of prohibiting a bank from offering incentives to employees to promote certain types of loans based on beneficial features, and not based on higher fees, such as refinances of hybrid ARMs with fixed rate loans, or CRA-eligible loans.

Moreover, the anti-steering provision would also require federal regulators to prescribe regulations to prohibit mortgage originators from steering any consumer to a mortgage "that is not in the consumer's interest." The regulators would also be required "to seek to ensure that such regulations . . . promote the interest of the consumer in obtaining . . . the best terms for a residential mortgage loan for which the consumer qualifies." This language is even more subjective than the "appropriateness" language described above, raises even greater challenges to implementation and enforcement, and would potentially expose banks to a greater degree of litigation risk.

Provisions Applicable to Subprime Mortgages

On its face, the bill would impose minimum general underwriting standards to a broad swath of mortgages: an ability to repay standard for all mortgages, and a net tangible benefit standard for any mortgage refinancing. But two important "safe harbor" exceptions apply. First, these general standards would not apply to prime mortgages, leaving them only to apply to subprime mortgages (including Alt A mortgages). Second, the general standards would not apply to "qualified safe harbor mortgages," *i.e.*, those subprime mortgages that meet certain specific, statutorily defined underwriting standards regarding verified income, debt-to-income ratios, etc. We believe that, to avoid liability, few securitizers would purchase subprime loans unless they were qualified safe harbor mortgages, and the same might well be true of lenders that intend to hold the loans on their balance sheets. As a result, the likely practical impact of the provision would be that nearly all subprime loans would have to meet the very specific underwriting standards necessary for qualified safe harbor mortgages, while the general standards would seldom come into play. Put another way, the qualified safe harbor mortgage could well become the federal prototype for subprime loans generally.

While the specifically required terms of these qualified safe harbor mortgages are similar to the federal banking agency standards, they are more stringent in a number of significant ways. For example, unlike the federal banking agency standards, a qualified safe harbor mortgage must have a debt-to-income ratio that does not exceed 50 percent; may not have negative amortization at any time; must always be based on income and financial resources that are verified (exceptions are permitted under the federal banking agency standards); and must as a practical matter have a fixed rate for at least the first seven years of the mortgage.[3] In addition, the bill separately prohibits prepayment penalties on all subprime loans, whereas the federal banking agency standards prohibit only those prepayment penalties that extend beyond the reset date of a subprime loan.

Taken as a whole, we believe these more stringent national underwriting standards would have a significant impact on subprime lending over time in that they would restrict the supply of credit. On the positive side, this reduction of credit would help ensure that the borrowers who obtain these loans could truly afford to repay them. On the negative side, the reduction would prevent some creditworthy borrowers from obtaining loans. In addition, the standards would narrow choices for all subprime borrowers (for example, by precluding virtually any form of adjustable rate mortgage). It is impossible to determine *ex ante* the extent to which creditworthy borrowers would be denied loans due to the new and stricter standards. But this is clearly a trade-off in the

[3] The safe harbor would permit adjustable rate mortgages where the rate is less than three percentage points above an acceptable index, but few subprime (or Alt A) mortgages could satisfy this test as a practical matter.

bill that should be recognized. In addition, the stricter standards would also prevent more existing subprime borrowers with adjustable loans from refinancing such loans.

Enforcement Provisions

Finally, the OCC believes that there is an important point to be made about the bill's enforcement remedies. On their face, the remedies appear even-handed because they apply equally to banks and nonbanks. But the reality is quite different. Because of existing enforcement provisions in federal banking law, application of the same set of bright-line standards to banks, brokers, and nonbanks would expose banks and their employees to a wide range of potential enforcement actions in the application of those standards, with no parallel system for enforcement of the standards applicable to brokers and non-banks. Put another way, banks and their employees would be subject to a stronger enforcement regime than nonbank lenders or mortgage brokers for the very same infractions of the bill's new provisions.

The very real concern is that uneven enforcement of the bill's new standards would result in raising the bar higher for banks than for nonbanks, which is surely not the bill's intent. Changes to the bill's enforcement standards are needed to ensure that the bill's standards are as effectively implemented and enforced at nonbank lenders and brokers as they would be at banks.

Conclusion

I appreciate the opportunity to present the OCC's views today. The legislation is a real start towards establishing truly national standards for subprime mortgage lenders and borrowers. It addresses a regulatory void by imposing standards for non-federally regulated mortgage brokers, and it would create a national database of mortgage originators who have been subject to sanctions, which would be beneficial to enforcement agencies as well as the public. In its current form, however, it does raise some significant concerns that we believe should be addressed.

We look forward to working with the Committee as its consideration of the legislation progresses, and we will be very happy to discuss these and other comments on particulars of the bill with Committee staff during that process.

STATEMENT

OF

THE HONORABLE JOANN M. JOHNSON
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

"LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES"

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

WEDNESDAY, OCTOBER 24, 2007

I. Introduction

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. It performs this important public function by examining all federal credit unions, participating in the supervision of federally insured state chartered credit unions in coordination with state regulators, and insuring credit union members' accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund, NCUA provides oversight and supervision to approximately 8,362 federally insured credit unions, representing 98% of all credit unions and approximately 87 million members.

II. Mortgage Lending in Federally Insured Credit Unions

Through the first half of 2007, the Mortgage Bankers Association estimated mortgage loan originations in the marketplace of over $1.33 trillion, of which federally insured credit unions originated only 2.14% or $28.3 billion.[1] Mortgage loans in federally insured credit unions represent only 9% of mortgage loans outstanding in all federally insured depository institutions.[2]

Nearly 60% of federally insured credit unions offer mortgage loans to their members. Those not offering mortgage loans are generally smaller credit unions that cannot afford the expertise or infrastructure to grant mortgages or manage mortgage portfolios. Additionally, smaller federal credit unions have difficulty implementing a wide range of mortgage products since loans to a single member are statutorily limited to 10% of a federal credit union's total unimpaired capital and surplus.[3] Consequently, as illustrated below, the majority of federally insured credit union mortgage lending occurs in larger credit unions:

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[1] Based on information available at the Mortgage Banker's Association website for 2007 Originations http://www.mbaa.org/files/Bulletin/InternalResource/57620_.pdf

[2] NCUA data and *FDIC- Statistics on Depository Institutions Report, 1-4 Family Residential Net Loans and Leases for all depository insured institutions as of 12/31/2006.* 31 Dec. 2006. Federal Deposit Insurance Corporation. < http://www2.fdic.gov/SDI/SOB>.

[3] 12 C.F.R. 701.21(c)(5). Unimpaired capital and surplus equals shares plus post-closing, undivided earnings.

Federally Insured Credit Unions by Asset Size	Number of Mortgage Loans Originated in 2007	% of Federally Insured Credit Union Mortgage Loan Portfolio as of 6/30/2007
Greater than $1 billion	248,762	44.75%
$500 million-$1 billion	113,184	17.59%
$50 million-$500 million	249,304	31.96%
$10 million-$50 million	42,323	5.28%
Less than $10 million	3,430	0.42%

Demand for mortgage loans in federally insured credit unions remains high. Mortgage loans led all loan types in growth in the first half of 2007, increasing $11.2 billion (93% of all new loan growth) to a new high of 50% of total loans. NCUA continues to closely watch performance indicators in the mortgage lending area through data collection and the examination and supervision process.

Composition of Mortgages in Federally Insured Credit Unions

As the following chart demonstrates, the majority of mortgage loans in federally insured credit unions are fixed rate, with almost all of the remainder being standard adjustable rate mortgages. Nontraditional mortgages are offered by less than 5% of federally insured credit unions and represent less than 2% of mortgage loans outstanding.

Type of Mortgage	Dollar Amount of Mortgage Loan Portfolio (billions)	% of Federally Insured Credit Union Mortgage Loan Portfolio as of 6/30/2007
Fixed Rate	$146	57.3%
Adjustable Rate	$109	42.7%
Interest Only or Payment Option[4]	$4.5	1.8%

Fixed rate mortgage loans accounted for 91% of the increase in mortgage loans in the first half of 2007. Fixed rate mortgages in federally insured credit unions grew at an annualized rate of almost 15% in the first half of 2007. Adjustable rate mortgage loans accounted for just 9% of the increase in mortgage loans in the first half of 2007, and grew at an annualized rate of just 2%. This indicates a clear preference by credit union members for fixed rate mortgage loans in the current economic environment, and likely includes a significant degree of refinancing of adjustable rate mortgages.

Nontraditional Mortgage Lending in Federally Insured Credit Unions

Given the growth in popularity of nontraditional mortgage products in the broader market (also referred to as "exotic," or "alternative" mortgage products), NCUA amended the 5300 Call Report to collect data on certain nontraditional first mortgage loans. Results for these mortgage products became available with the March 2007 reporting cycle.[5] The data indicates that these mortgage products (specifically "Interest-Only" or "Payment Option" mortgages) are only offered in a small number of federally insured credit unions and comprise a very small portion of the mortgage portfolio.

[4] NCUA does not capture information relating to the type (fixed or adjustable) of "interest-only" or "payment-option" loans, just the dollar amount outstanding for these loan products. This amount is reflected in the totals for both fixed and adjustable rate mortgage loans outstanding.
[5] NCUA's 5300 Call Report is the data collection tool used to collect required financial statement reports from federally insured credit unions on a quarterly basis.

There are several reasons why these riskier mortgage loans are not prevalent in federally insured credit unions. As earlier addressed, many federally insured credit unions are smaller institutions that lack the sophistication or resources to underwrite these types of loans. Also, as member-owned not-for-profit cooperatives, credit unions' lending motivation is designed to be member-oriented, appropriately concerned with the suitability and impact on the member. In addition, the Federal Credit Union Act prohibits prepayment penalties and establishes a statutory limit for interest rates.[6] Because of these statutory provisions, the regulatory environment for federal credit unions is not conducive to some of the features that make the cost of underwriting these loans more tenable to other types of institutions.

Mortgage Loan Performance in Federally Insured Credit Unions

NCUA's most current call report data indicates mortgage loan delinquencies greater than 30 days increased slightly in 2007, moving from 0.99% to 1.01%. Mortgage loan delinquencies over 60 days were at only 0.44% of total mortgage loans. While mortgage loan delinquencies in federally insured credit unions have increased overall over the last few years, the level of delinquency has remained sound and relatively consistent, as demonstrated in the following table:

Mortgage Loan Delinquency and Net Charge-Offs In Federally Insured Credit Unions					
Year Ending:	**2003**	**2004**	**2005**	**2006**	**06/2007**
Delinquency >30 days	0.83%	0.77%	0.79%	0.99%	1.01%
Delinquency >60 days	0.28%	0.25%	0.27%	0.34%	0.44%
Net Charge-Offs/Average Mortgage Loans	0.02%	0.02%	0.02%	0.03%	0.05%[7]

[6] The Federal Credit Union Act establishes a limit of 15% per annum inclusive of all service charges, with authority for the NCUA Board to establish a higher ceiling when certain economic conditions are met. The ceiling is currently set at 18%. 12 U.S.C. §§1757(5)(A)(vii) and 1757(5)(A)(viii).
[7] Annualized.

As also shown in the table above, the ratio of net mortgage loan charge-offs to average mortgage loans remains low at only 0.05%. The level of credit union mortgage loans in foreclosures ($165 million) remained stable during the first half of 2007. Mortgage loans in foreclosure represented only 0.06% of total mortgage loans outstanding at mid-year. Though the above mentioned mortgage loan figures indicate good performance, the slight increase in delinquent mortgage loans merit continued observation through routine supervision efforts.

III. NCUA's Ongoing Efforts to Promote Sound Risk Based Lending

NCUA has issued numerous pieces of guidance to federally insured credit unions on the safety and soundness principles of an effective risk based lending program.[8] These universal principals are applicable to the various types of mortgage lending programs.

<u>Lending Guidance Issued by NCUA</u>

Over the last several years, NCUA issued several pieces of guidance to outline risk based lending concepts. NCUA periodically issues guidance to federally insured credit unions through Letters to Credit Unions. Examiners routinely discuss the guidance set forth in these letters with credit union management and evaluate their responses through the examination and supervision function.

Recognizing the emergence of risk based lending efforts in the credit union industry, in 1995, NCUA issued Letter to Credit Unions 174 to all federally insured credit unions discussing the potential advantages and disadvantages to federally insured credit unions of risk based lending programs, or programs where subprime credit could be offered. Risk based lending involves setting a tiered pricing structure that assigns loan rates based upon an individual's credit risk. A tiered pricing structure enables federally insured credit unions to make more loans to disadvantaged, lower income, or credit-challenged individuals. Through a carefully planned risk-based lending program,

[8] Risk based lending is a means by which a credit union may be able to more effectively meet the credit needs of all its members. It involves setting a tiered pricing structure that assigns loan rates based upon an individual's credit risk. The precepts of risk based lending are more fully discussed in NCUA Letters to Credit Unions 174, *Risk Based Loans* and 99-CU-05, *Risk Based Lending*.

federally insured credit unions can make loans to somewhat higher-risk borrowers, as well as better serve their lower-risk members.

Letter to Credit Unions 174 stated that "[c]redit unions should engage in risk-based lending, not as a means of re-pricing existing balance sheets, but as a tool to reach out to the underserved..." and also noted that "[s]afety and soundness should remain of paramount importance...." Attached to Letter to Credit Unions 174 was an informational whitepaper discussing safety and soundness considerations and stressing the importance of consumer compliance issues related to risk based lending. Specifically, the whitepaper discussed the necessity of planning, policies, procedures, portfolio limitations and monitoring, and effective pricing. Additionally, the whitepaper reminded federally insured credit unions of their obligations under the Equal Credit Opportunity Act, Fair Housing Act, and the Fair Credit Reporting Act. Finally, the whitepaper outlined the examination procedures NCUA would use to review these programs.

In 1999, NCUA issued Letter to Credit Unions 99-CU-05 to all federally insured credit unions restating that soundly managed risk based lending programs were a way to reach out to all members. In Letter to Credit Unions 99-CU-05, NCUA noted that those receiving the largest benefit from risk based lending programs would be individuals attempting to repair or establish credit, but reiterated the need for sound planning, underwriting, monitoring, and control. Additionally, Letter to Credit Unions 99-CU-05 noted that a federally insured credit union's capital adequacy would be evaluated considering the volume and type of risk based lending pursued and the adequacy of the credit union's risk management program. Lastly, Letter to Credit Unions 99-CU-05 provided federally insured credit unions with more information about NCUA's expectations for risk based lending program planning, loan policies, and procedures.

In 2004, NCUA issued Letter to Credit Unions 04-CU-13 to all federally insured credit unions discussing NCUA's supervisory expectations for controls over several types of specialized lending programs, including subprime lending.

Subprime lending involves higher levels of risk and requires greater skill to successfully implement. Properly managed, however, it can be a viable and safe component of a federally insured credit union's balance sheet. A well-managed subprime program enables federally insured credit unions to serve disadvantaged members. Sound underwriting practices, effective control and monitoring systems and sufficient capital levels are key components to a well-managed program. All of these aspects are more fully discussed in NCUA's guidance on this topic.

Letter to Credit Unions 04-CU-13 outlined NCUA's underwriting expectations for federally insured credit unions engaged in subprime lending, noting the need to focus on borrowers' ability to repay loans as structured. A questionnaire on Subprime Lending Controls was also introduced to federally insured credit unions as an attachment to Letter to Credit Unions 04-CU-13. This questionnaire is currently used as part of the evaluation of risk based lending and subprime lending programs in federally insured credit unions with loan portfolios containing significant amounts of subprime loans.

In 2005, NCUA continued its efforts to address emerging risks in mortgage lending and concerns about alternative or exotic mortgage products in the overall mortgage market when a Supervisory Letter was issued to its examiners. The letter focused on the evolution of products in the mortgage market, the unusual volume of originations of variable rate mortgage products in a low interest rate environment, and the market trend toward liberalization of underwriting standards. The alert outlined potential issues with "interest-only" and "payment-option" adjustable rate mortgages with illustrations of payment shock for each of the products discussed.

The above referenced Supervisory Letter was then issued to federally insured credit unions in October 2005 with Letter to Credit Unions 05-CU-15, which also addressed the use of alternative or exotic mortgage products to afford housing in areas of high housing value appreciation. Additionally, Letter to Credit Unions 05-CU-15 notified federally insured credit unions that "NCUA field staff will be monitoring these trends and will evaluate not only interest rate risk related to mortgage lending but also the increased credit risk associated with these newer mortgage products and more liberal underwriting standards."

In 2006, NCUA issued Nontraditional Mortgage Guidance and began work on Proposed Subprime Lending Guidance, both in tandem with other regulators. While nontraditional and subprime mortgage lending are not major components of federally insured credit union mortgage portfolios, NCUA was concerned that predatory and unsound lending in other areas of the marketplace may increase consumers' monthly debt burdens significantly, resulting in a "ripple effect" that would not only impact credit union members but also federally insured credit union asset quality. If credit union members begin to experience difficulty making payments on homes they have financed elsewhere, loan accounts at their federally insured credit unions could also be impacted.

As a result of comments received on the consumer protection section of the proposed Nontraditional Mortgage Guidance, the agencies crafted proposed illustrations of Consumer Information for Nontraditional Mortgage Products.[9] These illustrations are designed to assist consumers by providing examples of model or sample disclosures or other descriptive materials as part of the Interagency Nontraditional Mortgage Guidance.

Then in April of 2007, NCUA and the other FFIEC member agencies jointly released a statement encouraging financial institutions to work constructively with residential mortgage borrowers who may be unable to meet their contractual payment obligations. This joint statement explains that prudent workout arrangements consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

[9] See 71 FR 58672.

In July of 2007, NCUA and the other FFIEC member agencies jointly released a finalized Interagency Statement on Subprime Mortgage Lending[10] to address emerging risks and lending practices associated with certain subprime adjustable rate mortgage products that can cause payment shock to consumers. As with nontraditional mortgage products, although these types of loans do not appear to be prevalent in the credit union industry, the NCUA cautioned federally insured credit unions on the potential "ripple" effect to their asset quality if some of their members have these types of loans at other financial institutions and are struggling to repay considerably higher priced mortgage payments. As with the Interagency Nontraditional Mortgage Guidance, the agencies issued proposed illustrations to assist financial institutions in implementing the guidance specifically related to the consumer protection section of this document.

Just last month, NCUA, the other FFIEC member agencies, and the Conference of State Bank Supervisors jointly issued a statement encouraging federally regulated financial institutions and state-supervised entities that service securitized residential mortgages to review and determined the full extent of their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss mitigation strategies designed to preserve homeownership. Appropriate loss mitigation strategies may include, for example, loan modifications, conversions of an adjustable rate mortgage into a fixed rate mortgage, deferral of payments, or extending amortization. In addition, this issuance suggests institutions consider referring appropriate borrowers to qualified homeownership counseling services that may be able to work with all parties to avoid unnecessary foreclosures.

Examination & Supervision Efforts

NCUA monitors safety and soundness of federal credit unions through a risk-focused examination program. This program, introduced in 2002, allows examiners to focus their attention on areas of high or increasing risk across seven specific categories;

[10] The agencies published for comment the proposed Statement on Subprime Mortgage Lending on March 8, 2007. See 72 FR 10533.

credit risk, interest rate risk, liquidity risk, transaction risk, compliance risk, strategic risk, and reputation risk. Issues of concern identified during examinations can impact the level of risk in more than one of these risk categories; from a consumer protection viewpoint, the topic of mortgage lending most notably impacts compliance risk and reputation risk.

The risk-focused examination program leverages off of the experience and knowledge of examiners to focus attention on areas of greater risk, thereby more effectively utilizing agency resources. Examiners are not required to review all compliance areas during each safety and soundness examination. However, if the examiner is aware of specific issues with violations or member complaints stemming from mortgage-related issues, they are expected to expand their scope and review this area. Any issues identified are documented and discussed with management. For significant issues identified, examiners reach formal agreements with the officials to implement corrective action. For non-material isolated instances, examiners address these as informal discussion items or minor matters requiring management attention.

In addition to the typical lending questionnaires to capture issues with mortgage-related lending regulations, including but not limited to, Equal Credit Opportunity Act, Home Mortgage Disclosure Act, Fair Housing Act, Real Estate Settlement Procedures Act, and Truth in Lending, NCUA examiners can utilize a series of optional checklists for specialized lending programs. Examiners can select from a series of questionnaires tailored to specific lending arrangements or programs; such programs addressed include outsourced lending relationships, indirect lending controls, and sub-prime lending controls.

NCUA has devoted an entire section of the *Examiner's Guide* outlining procedures to evaluate a credit union's compliance with consumer protection issues, including real estate lending. In addition, NCUA developed and published a *Consumer Compliance Self Assessment Guide* to aid a credit union's board of directors and management, compliance officers, and others with compliance responsibility in meeting their duties and obligations. The *Consumer Compliance Self Assessment Guide* contains Overviews, Review Considerations, Checklists, and Glossaries specifically relating to the Fair Housing Act, the Homeowner's Protection Act, the National Flood Insurance Act / Flood Disaster Protection Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and Truth in Lending.

Member Complaint Process

NCUA is aware potential issues involving consumer compliance regulations may occur outside of an examination. Thus NCUA also has a formal process in place to collect and act on complaints received by credit union members. Members are made aware of NCUA's role in the complaint resolution process through two primary methods: 1) NCUA is listed as a point of contact on Statement of Adverse Action notices provided to members whenever a request for credit at a Federal Credit Union is denied; and 2) NCUA's Internet site provides a toll free consumer assistance hotline number and email contact information to report complaints.[11] Most complaints received by NCUA are in the form of a written letter by the member.

NCUA's complaint process is designed to encourage members to work with the credit union to resolve issues. Typically, NCUA initially directs the FCU to investigate the complaint and provide the member a response with a copy to NCUA, or respond directly to NCUA. NCUA will then review the credit union's response and, if warranted, may further investigate the complaint. NCUA reviews all complaints for regulatory and consumer compliance violations. When a violation occurs, the violation is logged in NCUA's Consumer Regulation Violation Log (CRVL) for necessary follow-up through our safety and soundness examination program.

NCUA's central and regional offices have systems to track incoming complaints and responses. Each NCUA regional office has staff responsible for reviewing and evaluating consumer complaints. For complaints regarding state chartered credit

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[11] See http://www.ncua.gov/ConsumerInformation/Consumer%20Complaints/complaintmain.htm.

unions, NCUA will coordinate with the appropriate state regulator. FCUs have supervisory committees comprised of credit union members whose primary duties include member protection, oversight of internal audit functions, and ensuring credit union member assets are safeguarded.[12]

The statutory purpose of the supervisory committee is to ensure independent oversight of the board of directors and management and to advocate the best interests of the members. Consistent with this responsibility, the Federal Credit Union Act provides supervisory committee members with the authority, by unanimous vote, to suspend any board member, executive officer, or credit committee member.

As the members' advocate, supervisory committees are responsible for investigating member complaints. Complaints cover a broad spectrum of areas, including compliance matters, annual meeting procedures, dividend rates and terms, and credit union services. Regardless of the nature of the complaint, NCUA expects supervisory committees to conduct a full and complete investigation.

The supervisory committee investigates each complaint referred to them by NCUA and provides an explanation of the circumstances directly to NCUA. NCUA encourages the resolution of the matter voluntarily, but is authorized and prepared to invoke administrative action authority, if necessary, to achieve a proper outcome. Regional Directors are responsible for making determinations about necessary action on a case-by-case basis and coordinate their responses with NCUA's central office.[13]

Generally speaking, the overwhelming majority of member complaints, regardless of the particular issue, stem from either the member's misunderstanding of the FCU's policies or poor initial communication between the credit union and the member. As a result, virtually all complaints are resolved after NCUA directs the FCU to address the complaint with its member and communicate with the member. Following a final review

[12] State chartered credit unions have comparable oversight function.
[13] NCUA Instruction No. 12400.05, dated April 23, 2004.

of the matter, NCUA sends the member a letter that summarizes the results of the review and advises the member in writing of its understanding that the complaint is resolved.

Consumer Protection for Credit Union Mortgage Applicants

Credit unions must comply with the same mortgage specific federal regulations as other federally insured institutions, including: Truth in Lending (Regulation Z), the Real Estate Settlement Procedures Act (RESPA), the Home Owner's Equity Protection Act (HOEPA), the Flood Disaster Preparedness Act (FDPA), the Fair Housing Act (FHA), and the Home Mortgage Disclosure Act (HMDA).[14] NCUA's examiners review compliance with applicable laws and regulations in the normal course of the examination and supervision process.

As the enforcement authority for HMDA in credit unions, NCUA is responsible for the oversight of HMDA data collection.[15] For the 2006 reporting period, approximately 2,060 institutions overseen by NCUA for the purpose of HMDA reporting submitted loan/application register data. The respondents included federally insured credit unions, non-federally insured credit unions, and credit union service organizations. Combined, the NCUA respondents submitted data for 820,538 loan applications.

Based on the HMDA data collected, credit unions appear to be actively meeting the need for mortgage products among credit union applicants for mortgage credit. Reporting credit unions approved an overwhelming majority of the applications processed during the 2006 reporting period. Approximately 67% of all applications resulted in a loan origination. Moreover, the reporting credit unions denied fewer than 14% of all applications. Of the total applications processed, 12.30% resulted in a denial of credit and 1.45% resulted in a denial of a request for pre-approval of credit.

[14] These laws also apply to privately insured credit unions.
[15] NCUA is responsible for HMDA data collection for federally insured and privately insured credit unions.

Credit unions are also serving underserved areas with mortgage products. When credit unions complete the loan/application registers, they identify the location of the properties under consideration by census tract. The HMDA data compares the income levels of the census tracts of the properties under consideration to the income levels of the larger metropolitan statistical areas (MSA) that encompass the properties. NCUA uses a similar methodology when determining, for the purposes of chartering policy, if an area qualifies as underserved. An area with a median family income level at or below 80% of the median family income for the larger metropolitan statistical area is underserved.

Census tract income information was available for approximately 90% of the mortgage loan applications reported. For underserved areas, 63% of mortgage loan applications the credit unions processed resulted in originations, with fewer than 19% of the mortgage loan applications that included property in underserved areas denied. The approval rate in areas for mortgage loans in non-underserved census tracks was 67%, with only approximately 13% denied. During 2006, reporting credit unions originated over 548,000 mortgages, with 13% of those originations occurring in underserved areas.

IV. NCUA Perspectives on Mortgage Reform Legislation

NCUA is pleased to offer comments regarding various legislative proposals before the House Financial Services Committee. The primary focus will be on H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act, introduced by Chairman Barney Frank. NCUA will also comment on H.R. 3878, the Escrow, Appraisal and Mortgage Servicing Improvements Act, introduced by Congressman Paul Kanjorski and others.

This statement will address the legislation in the above-described order. NCUA recognizes and supports H.R. 3915's goal of making all persons originating mortgage loans to consumers accountable for their consumer mortgage practices. The agency believes establishing licensing and registration requirements and providing certain minimum standards for consumer mortgage loans work to enhance consumer protection and to ensure underwriting standards used by mortgage originators are consistent with prudent lending practices. The legislation's application to all mortgage originators, including those that are not depository institutions or institution-affiliated parties of a depository institution, further contributes to these worthy goals.

Rulemaking Authority under the Proposed Legislation

Rulemaking authority under the proposed legislation is given variously, and in several sections, to the Secretary of Housing and Urban Development (Secretary), the Comptroller of the Currency (OCC), the Director of the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC) and the Federal Trade Commission (FTC). Title I, Sections 102 and 103 require joint rulemaking by the Secretary, OCC, OTS and FDIC, in consultation with the FTC, to prescribe, respectively, regulations implementing stated requirements and establishing such other requirements as may be appropriate for residential mortgage loan origination purposes and anti-steering regulations. Section 104, paragraph (d) charges the OCC, OTS, and FDIC (the Federal banking agencies), in consultation with the Secretary, to jointly prescribe licensing and registration regulations for depository institutions and institution-affiliated parties of depository institutions.

The terms depository institution and institution-affiliated parties of depository institutions would include a credit union and its credit union service organization (CUSO) affiliate. Under Title II, the Federal banking agencies are tasked with jointly prescribing regulations to define the term "net tangible benefit" under Section 202; to carry out the purposes of Section 203 concerning safe harbor mortgages and the rebuttable presumption that the minimum standards for residential mortgage loans and the net tangible benefit for refinancing residential mortgage loans are met; to ensure that assignees exercise reasonable due diligence in purchasing residential mortgage loans by establishing regulations for adequate, thorough, and consistently applied sampling procedures; and, to prescribe the manner in which a creditor describes negative amortization to a consumer under section 206.

Though credit unions are properly subject to this legislation, none of these regulators have supervisory and enforcement authority for federally insured credit unions. NCUA is concerned that important aspects of credit union operations, as well as appropriate regulatory distinctions, may be overlooked by regulators unfamiliar with the NCUA and the credit union industry. For example, not all CUSOs qualify as a credit-union affiliate; federal credit unions may not charge a prepayment penalty; and certain compensation arrangements in connection with a loan are prohibited under NCUA's lending rules. In addition, the legislation amends the Truth in Lending Act, which is implemented by the Federal Reserve Board's Regulation Z and NCUA is responsible for examining and enforcing federal credit union compliance with Regulation Z.

Given the potential impact of the bill and resulting regulations on federally insured credit unions, NCUA respectfully requests that joint rulemaking authority include the agency in the above referenced provisions.

Additional Mortgage-Related Legislation

Congressman Kanjorski's bill, H.R. 3837, is also relevant to the discussion of possible reforms to other aspects of the home mortgage lending industry. Title I of the legislation establishes a requirement for the use of escrow accounts to pay property taxes, insurance premiums, and other required periodic payments in connection with a loan secured by a mortgage or deed of trust on a single-family, owner-occupied dwelling under certain conditions, addresses restrictions on force-placed insurance, requires comprehensive studies on mortgage servicing fraud and mortgage servicing improvements, and requires escrow payments to be included in a repayment analysis.

NCUA commends the Congressman's interest in addressing these mortgage servicing issues, particularly those that enhance transparency and consumer disclosures. As the legislation moves forward, NCUA will provide additional information on the relative benefit of these changes to consumers and their operational impact on credit unions.

NCUA and the Role of Consumer Financial Education

NCUA and the credit union industry have historically placed significant emphasis on programs that enhance and expand the financial literacy of credit union members. These efforts are directed at several elements of basic financial education, notably those concerning homeownership. NCUA has implemented several programs to encourage federally insured credit unions to expand homeownership opportunities and provide financial education to members.

Studies have indicated that the single most important step that could be taken to improve home ownership opportunities and retention, particularly among low-income borrowers, is the expansion of financial education and counseling. Additionally, studies also suggest that the growth of subprime lending in recent years has not been accompanied by a commensurate emphasis on financial literacy. Lending done by insured depositories such as banks, thrifts, and credit unions can and should have financial education as an integral part of any lending process.[16]

NCUA is a member of the Financial Literacy and Education Commission (the Commission), a federal entity established under the Financial Literacy and Education Improvement Act, enacted by Title V of the Fair and Accurate Credit Transactions Act of 2003, to improve financial literacy and education of persons in the United States.

The principal duties of the Commission include: (1) encouraging government and private sector efforts to promote financial literacy; (2) coordinating financial education efforts of the federal government, including the identification and promotion of best practices; (3) the development of a national strategy to promote financial literacy and

[16] "Strengthening the Ladder for Sustainable Homeownership," prepared by the National Housing Conference for the Annie E. Casey Foundation, February 2005, page 18. Established in 1948, the Foundation's stated mission is to foster public policies, human service reforms, and community support that more effectively meet the needs of today's vulnerable children and families.

education among all American consumers; (4) the establishment of a website to serve as a clearinghouse and provide a coordinated point of entry for information about federal financial literacy and education programs, grants, and other information; and (5) the establishment of a toll-free hotline available to members of the public seeking information about issues pertaining to financial literacy and education.

In addition to serving as a member of the Commission, NCUA Chairman JoAnn Johnson has served as Chairman of its MyMoney.gov website subcommittee since October 2006. The MyMoney.gov web site was created to provide public access to financial education tools and resources, which will empower Americans to save, invest and manage money wisely to meet personal goals. In this role, the Chairman coordinates the efforts of twenty federal agencies to improve financial education across the nation.

Based on empirical and anecdotal evidence, NCUA stands behind comprehensive, accessible and understandable financial education aimed at homeowners as an essential first step in giving consumers a fair chance to gain control of their financial future. NCUA will continue to explore new and innovative ways to promote this to the credit union industry and to the consumers who choose a credit union for home mortgage borrowing. NCUA's view is that while financial education is not a panacea or a substitute for strong and robust regulation and oversight of consumer protection laws, it is an important and cost-effective way to equip consumers with basic understandings of a very complex financial landscape.

V. Conclusion

Consumers face an increasingly complex financial landscape where the expansion of choices has been accompanied by a corresponding number of potentially disadvantageous and costly options. While the availability of new and innovative mortgage products has been beneficial to a large segment of the American public, too often these products have been offered to consumers who are unaware of the totality of the financial terms and conditions involved.

NCUA supports any responsible legislative effort that enhances consumer protection while preserving and expanding consumer ability to determine what mortgage products and services best suit them. Congress should concentrate on promoting a legal regime that not only eliminates negative anti-consumer lending practices but also improves upon the understandability and usefulness of consumer protections in such a way that adds to the borrower's understanding of the process, rather than simply adds to the number of pieces of paper in a settlement package.

Markets work best when aware consumers evaluate their options and make informed decisions. NCUA encourages Congress to keep that notion in the forefront as it engages in the commendable effort to improve mortgage lending for all consumers.

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Statement of

Randall S. Kroszner

Member

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

October 24, 2007

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate the opportunity to appear before you today, to discuss recent problems in the subprime mortgage market, Federal Reserve actions that address these developments, and potential legislative responses. Promoting access to credit and sustainable homeownership are important objectives, and the Board believes that responsible subprime mortgage lending can help advance both goals.

Background

Subprime mortgages are loans intended for borrowers who are perceived to have higher than typical credit risk. In recent years, the subprime market has grown dramatically because of advances in credit scoring and underwriting technology, which enables lenders to charge different borrowers different prices on the basis of calculated creditworthiness. These loans are recognized by the higher prices they carry, which reflect subprime lenders' decisions to seek additional compensation for the credit risk they incur.

As the overall mortgage market has grown, many new lenders and distribution channels have developed and most of those are outside the direct jurisdiction of the federal banking agencies. A review of data provided by mortgage lenders pursuant to the Home Mortgage Disclosure Act reveals that lenders that are not subject to oversight by a federal banking agency originated just under half of the higher-priced conventional first lien mortgage loans reported in 2006.

While the expansion of the subprime mortgage market over the past decade has increased access to credit, the subprime mortgage market during recent years was also accompanied by a deterioration in underwriting standards. In some cases, abusive or fraudulent lending practices resulted in homeowners taking on mortgage obligations they could not afford, with terms they may not have fully understood. Delinquencies and foreclosures have increased. During the past two years, serious delinquencies among subprime adjustable-rate mortgages (ARMs) have increased dramatically, reaching nearly 16 percent in August, roughly triple the recent low in mid-2005. For so-called near-prime loans in alt-A securitized pools (those made to borrowers who typically have higher credit scores than subprime borrowers but still pose more risk than prime borrowers), the serious delinquency rate has also risen, to 3 percent from 1 percent only a year ago. These patterns contrast sharply with those in the prime-mortgage sector, in which less than 1 percent of loans are seriously delinquent.

Higher delinquencies have begun to show through to foreclosures. About 320,000 foreclosures were initiated in each of the first two quarters of this year (just more than half of them on subprime mortgages), up from an average of about 225,000 during the past six years. Foreclosure starts tend to be high in states with stressed economic conditions and to rise where house prices have decelerated or fallen. Adjustable-rate subprime mortgages originated in 2006 have performed the worst, with some of them defaulting after only one or two payments (or even no payment at all). Relative to earlier vintages, more of these loans carried greater risks beyond weak borrower credit histories--including very high initial cumulative loan-to-value ratios and less documentation of borrower income.

The recent increase in delinquencies and foreclosures has created personal, financial, and social distress for many homeowners and communities. We encourage servicers of securitized mortgages to reach out to financially stressed homeowners. Keeping families in their homes is a matter of great importance to the Federal Reserve. In fact, the twelve Federal Reserve Banks are working closely around the country with community and industry groups dedicated to reducing homeowners' risks of foreclosure. Each of the Reserve Bank community affairs offices provides significant leadership and technical assistance in this area.

I am also pleased to serve as the Federal Reserve's representative on the board of directors of NeighborWorks America, which has a program to encourage borrowers facing mortgage payment difficulties to seek help by making early contact with their lenders, servicers, or trusted counselors. NeighborWorks' Center for Foreclosure Prevention Center recently launched a national advertising campaign to raise awareness about its 24-hour national hotline that connects struggling borrowers with homeownership counselors. Since the launch of the campaign this past June, the daily call volume has almost doubled from 1,000 to almost 2,000 calls a day.

The Board's Response to Problems in the Subprime Market

The Federal Reserve has primary rule-writing authority for many consumer protection laws. Consumer protection laws take two complementary approaches to consumer protection: one focuses on the provision of information, and the other involves the development and enforcement of rules against abusive practices. The Board believes it is extremely important to strike the right balance by seeking to protect consumers from predatory lending practices without restricting credit from responsible lenders to borrowers with shorter or lower-rated credit histories. To achieve that balance, we coordinate with other federal and state agencies, and consult with consumer advocates, lenders, investors, and other interested parties.

Consumer protection regulations

The Board believes it is important to provide consumers with pertinent and accurate information. Clearly, information is critical to the effective functioning of markets. A core principle of economics is that markets are more competitive, and therefore more efficient, when accurate information is available to both consumers and suppliers. When information on alternatives is readily available, product offerings must meet customers' demands and offering prices must reflect those of market competitors. If consumers are well informed, they are in a better position to make decisions that are in their best interest. As a result, a significant component of the rule-writing process involves crafting disclosure requirements that provide consumers with consistent and relevant information about the terms and fees of financial products.

To be effective, disclosures must give consumers information that they can readily understand at a time when the information is relevant. To that end, the Federal Reserve will propose improvements to the rules governing the disclosure of mortgage loan terms and conditions and the timing of those disclosures. We will soon begin an extensive consumer testing process to ensure that the new disclosures we propose will be comprehensible and useful to borrowers. To further improve consumers' access to meaningful information, we are also developing proposed changes to the Truth in Lending Act (TILA) rules to address concerns about incomplete or misleading mortgage loan advertisements and solicitations, and to require lenders to provide mortgage disclosures more quickly so that consumers can get the information they need when it is most useful to them.

The Federal Reserve is keenly aware, however, that disclosure alone may not be sufficient to combat abusive practices. In addition to providing consumers with better information, the Federal Reserve plans to exercise its rulemaking authority under the Home Ownership and Equity Protection Act (HOEPA) to address unfair or deceptive mortgage lending practices. We plan to propose rules by the end of this year that would apply to subprime loans offered by all mortgage lenders. We share the concerns of Congress that certain lending practices may have led to the problems we are seeing in the subprime market today. We are looking closely at practices such as prepayment penalties, failure to offer escrow accounts for taxes and insurance, stated-income and low-documentation lending, and the failure to give adequate consideration to a borrower's ability to repay.

To ensure that any new rules will protect consumers without inappropriately reducing access to credit, the Board has obtained input from a wide variety of interested parties. I chaired a full day hearing in June that yielded valuable insight from both industry and consumer groups. The Board also solicited written comments from the public on the practices discussed at the hearing. The Board received nearly 100 comment letters, and staff is closely examining the issues raised and discussing possible remedies. Other federal and state agencies have been consulted as part of our efforts under HOEPA. We have also sought the views of our Consumer Advisory Council, which advises the Board on matters in the area of consumer financial services. The council's members represent the interests of consumers, communities, and the financial services industry.

Coordinated enforcement of consumer protection laws

Enforcement of consumer protection measures is also critical to protecting consumers from irresponsible or predatory lending. Indeed, the consumer financial services laws implemented by the Federal Reserve contain a number of substantive protections, reflecting carefully considered judgments by Congress that certain practices should be restricted or prohibited. The Federal Reserve enforces these rules through oversight of the institutions it examines for compliance with consumer protection laws and regulations.

The regulatory scheme for the mortgage industry has become extremely complex as the breadth and depth of this market has grown over the past decade and the role of nonbank mortgage lenders, particularly in the subprime market, has increased. As I mentioned previously, data collected under the Home Mortgage Disclosure Act show that independent mortgage companies made about half of higher-priced mortgages in 2006. In addition, there has been an increased presence of mortgage brokers, often independent entities who take loan applications and shop them to depository institutions or other lenders. These market developments have resulted in mortgage lending extending beyond the federal banking agencies' oversight, and this underscores the importance of collaborating with the state banking agencies and other organizations to address concerns in the subprime mortgage market.

To this end, we have launched a cooperative pilot project with other federal and state agencies to conduct reviews of non-depository lenders with significant subprime mortgage operations. The reviews will evaluate the companies' underwriting standards and senior-management oversight of risk-management strategies for ensuring compliance with consumer protection laws and regulations. Our partners in this initiative are the Office of Thrift Supervision, the Federal Trade Commission, and state agencies represented by the Conference of State Banking Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR). At the conclusion of the reviews, the agencies will analyze the results and determine whether to continue the project and, if so, how to focus future reviews.

Loss mitigation efforts

The Board also has worked with the other federal financial agencies to guide federally supervised institutions as they deal with borrower mortgage default. In April 2007, the federal financial institution agencies issued a *Statement on Working with Mortgage Borrowers.* The statement encourages federally regulated institutions to work constructively with residential borrowers at risk of default and to consider prudent workout arrangements that avoid unnecessary foreclosures. In cooperation with CSBS, the federal financial agencies issued a *Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages* in

September 2007 to address subprime and other mortgage loans that have been transferred into securitization trusts. The statement calls on servicers of securitized mortgages to review the governing documents for the trusts to determine the full extent of their authority to restructure loans that are delinquent or in default or are in imminent risk of default.

To the extent possible, efforts should be made to avoid foreclosure. We encourage servicers to reach out to financially stressed homeowners, to make every effort to keep them in their homes. Lenders and servicers, for example, may be able to assist troubled borrowers by modifying the loan, deferring payments, extending the loan maturities, converting an adjustable-rate mortgage to a fixed-rate or fully-indexed loan, or capitalizing delinquent amounts. The best outcome is a loss mitigation strategy that results in a mortgage obligation that the borrower can meet in a sustained manner. The use of these and other loss-mitigation techniques is consistent with the interagency guidance that emphasizes the importance of prudent underwriting practices to help ensure that borrowers can meet the terms of their mortgage obligations and maintain homeownership.

Legislative Responses

Congress is appropriately concerned about problems in the mortgage market. The Mortgage Reform and Anti-Predatory Lending Act of 2007 takes a comprehensive approach and is appropriately focused on the more problematic practices in the subprime mortgage market. We share Congress's concerns with these practices. As with regulations, it is important that new laws carefully target lending abuses without unduly restraining responsible lending. Getting this balance right is particularly critical now, as many borrowers facing rate adjustments may need to refinance into more affordable loans.

The Mortgage Reform and Anti-Predatory Lending Act of 2007 would provide greater oversight and regulation of mortgage brokers, an approach that has merit. A nationwide registration and licensing system for all mortgage loan brokers would help limit the ability of bad actors to move to a new state after having run afoul of regulators in other states. The CSBS and AARMR have a promising initiative to establish a national registry. It would be appropriate for any new legislation to ensure that all individual brokers are included in the same nationwide registry.

The Mortgage Reform and Anti-Predatory Lending Act of 2007 also addresses concerns about loans made without consideration of a borrower's ability to repay. The Board firmly believes that lenders should give due consideration to a borrower's ability to repay a loan, before the loan is extended. We and the other regulators have emphasized this several times in a variety of guidance statements on mortgage lending. This is also one of the areas we are looking at in our revisions to the HOEPA rules. In developing laws or rules to address repayment ability, the rules must be specific enough so that creditors can determine whether their practices are in compliance because legal uncertainty could have the unintended effect of reducing credit options for creditworthy subprime borrowers. At the same time, rules must be flexible enough to allow creditors to consider the pertinent factors and individual circumstances of particular consumers and to innovate prudently and fairly.

The Mortgage Reform and Anti-Predatory Lending Act of 2007 would require originators to present borrowers with loans that are appropriate to the borrower's circumstances. In the case of refinancings, the bill provides that the loan must provide a "net tangible benefit" to the borrower. As I have discussed, the Board supports the goal of ensuring that consumers do not receive unaffordable and abusive loans. However, it is critical to carefully craft such laws or rules to ensure that they do not inappropriately reduce credit availability in the mortgage market, to the detriment of consumers.

The Mortgage Reform and Anti-Predatory Lending Act of 2007 would hold securitizers and loan purchasers ("assignees") liable for the actions of mortgage originators. The securitization market is critical to increasing the resources available to fund home purchases and great care should be taken to ensure that investors in the securitization market can quickly and accurately assess and mitigate the risks, including the compliance risks, of mortgages sold in this market. Such laws should be very clearly delineated to ensure that they do not have a detrimental impact on the ability of lenders to securitize loans. Specifically, assignees must be able to conduct due diligence and determine whether an originator has complied with the law, so that they can evaluate and price for any risks.

Finally, the bill would enhance HOEPA's protections by prohibiting abusive practices, such as prohibiting the financing of single-premium credit life insurance. HOEPA's points and fees trigger would be lowered and additional fees added. These potential actions merit discussion, and we welcome the opportunity to continue to work with congressional staff on these and other provisions in new legislation.

Conclusion

The Board is engaged in several activities to assist consumers, and continues to develop rules that will improve consumer disclosures, address unfair or deceptive practices, and help consumers facing default and foreclosure. We look forward to working with Congress to enhance consumer protection laws while maintaining access to credit.

TESTIMONY OF
MARC E. LACKRITZ
PRESIDENT AND CEO
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

HEARING ENTITLED
"LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES"

OCTOBER 24, 2007

Introduction

Mr. Chairman and members of the Committee:

My name is Marc Lackritz and I am President and CEO of the Securities Industry and Financial Markets Association ("SIFMA").[1] I am pleased to provide the views of both SIFMA and the American Securitization Forum ("ASF")[2] on H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act."

We commend you and your staff for a fair and participatory process in the development of this legislation. The legislation seems true to the goals that you outlined when you began examining this subject earlier this year, and we appreciate the opportunity to provide additional comments. The Committee has tried to stay true to a simple principle – namely, that a borrower should not get a loan that he or she cannot afford and from which he or she does not benefit. Moreover, a borrower should be able

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

[2] The American Securitization Forum is a broadly-based professional forum through which participants in the U.S. securitization market express their common interests on important legal, regulatory and market practice issues. ASF's membership – over 350 organizations in all – includes securitization issuers, investors, servicers, financial intermediaries, trustees, rating agencies, legal and accounting firms, and other securitization market participants. ASF is an adjunct forum of SIFMA. (Additional information about the ASF, its members and activities is available at www.americansecuritization.com.)

to get out of any loan that breaches this simple standard. We support that framework as the system works best when we can keep families in their homes.

The beauty of our housing finance system has been its continued ability to innovate and develop new techniques to best reach and serve all market participants. Occasionally, some of these techniques do not work as well as they are intended. Importantly, we cannot overreact in crafting legislation to address the abuses that have occurred in a very small segment of the lending market. Indeed, the market has already adjusted to the rise in delinquencies with dozens of subprime lenders exiting the market altogether and others eliminating practices that did not work or tightening their lending standards. There are limits to the uncertainty and liability that an investor will accept without taking its money and investing elsewhere, especially when it involves increasingly global capital flows. We urge the Committee to bear that in mind when determining the final features of the bill.

Background

Despite the current troubles in the home mortgage market, the United States has a housing finance system that has been extremely successful in making the dream of home ownership available to millions of Americans. Home mortgage credit has been more widely available at a lower cost because of securitization and the secondary mortgage market.[3] The secondary market efficiently links mortgage borrowers to the capital markets and enables lenders to provide more credit at a lower price than they otherwise could. Over the past decade, securitization and the secondary market has expanded access to credit for all borrowers. Today, nearly 70 percent of American households own their own homes, a historically high figure.

In addition, Congress has consistently supported and promoted securitization by enacting laws to make the secondary mortgage market more efficient. Congress created Ginnie Mae, Fannie Mae and Freddie Mac to promote securitization as a means of expanding mortgage lending. Other laws such as the Secondary Mortgage Market Enhancement Act of 1984 and the REMIC provisions of the Tax Reform Act of 1986 specifically recognized the benefits of securitization in expanding home ownership and making the securitization process vastly more efficient.

Major Concerns

We are concerned that several provisions of the current legislation could significantly reduce funding from the secondary mortgage market and cut off mortgage credit for worthy subprime borrowers.

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[3] In conformity with market usage, the "secondary mortgage market" generally means the process whereby home loans are indirectly financed by investors' purchasing mortgages and mortgage securities from lenders who directly make loans to homebuyers.

National Standards are Needed

The single biggest deficiency in the bill is the lack of federal preemption of state laws. Although we understand that you intend for Title II to be preemptive, we believe such a preemption should be explicitly stated. The bill requires a lender to determine both that the borrower has the ability to repay a loan and that the loan provides a net tangible benefit to the borrower before the loan is made. Reasonable people can differ on whether a borrower should have such a statutory right to require the lender to be responsible to protect the borrower from making bad choices. We acknowledge that the proposal at some levels tries to balance the interests of borrowers and lenders on this point. Nevertheless, we believe this should be a single, national standard, which is not subject to 50 variations flowing from state legislation. Without such preemption, this bill will only add to the patchwork of regulation which regulates mortgage lending, and will increase the costs of compliance which likely will be passed on to end borrowers.

Secondary Market Liability Must be Targeted

Although we do not think that liability for the secondary market for actions of brokers or originators is appropriate, we do recognize and appreciate that the bill limits the exposure of the secondary market investors and trusts. The bill also limits the damages that a securitizer (sponsor) of the trust has, should the worst-case scenario arise. We believe the bill should ensure that the cure remedy is made preferable to rescission. In that respect, the bill should clarify that the 90-day cure period starts from the time the securitizer or assignee receives the claim notice either directly from the borrower or indirectly through the servicer or other third party. The bill should affirmatively state that a consumer loses the right to a rescission if the consumer rejects a qualifying offer to cure. Moreover, a borrower should not have the right to rescind a loan that he or she procured through fraud or misrepresentation.

We remain concerned that the liability has been expanded beyond the "securitizer." We understand that the Committee may want to ensure that an investor who buys and holds loans rather than securitizes them is not insulated from liability. At the same time, however, the ability of a borrower to bring an action against any party that ever had an interest in the loan will create chaos in the marketplace. We recommend that the term "assignee" be narrowly defined to be "the entity, other than a Securitization Vehicle, that owns the residential mortgage loan at the time the consumer makes the claim." Section 131 of the Truth in Lending Act ("TILA") currently provides that a loan servicer that holds legal title to a loan to conduct the servicing function is not considered an assignee for purposes of TILA, and we believe that provision should apply here as well.

One of the elements of this safe harbor provides that the securitizer/assignee must exercise reasonable due diligence based on a sample of loans to make sure that the loans are qualified mortgages or qualified safe harbor mortgages. We are very concerned that finding one ineligible loan would cause the safe harbor to evaporate. Accordingly, we suggest that the bill clarify that the exercise of commercially reasonable due diligence based on a sample of loans is intended to prevent the assignee or securitizer from knowingly purchasing or taking assignment of a pool of mortgages as to which a *material* portion of such mortgages are not qualifying mortgages or qualifying safe harbor mortgages.

Defining Qualified Mortgages and Qualified Safe Harbor Mortgages

We are concerned about the scope of loan products which will fall into the safe harbor provisions in Section 203, that is, how many loans will be "qualified mortgages" and "qualified safe harbor mortgages." Typically, where broad unlimited assignee liability exists, such as under the Home Ownership and Equity Protection Act, ("HOEPA") for high-cost loans, the market simply dries up. Loans are rarely made and certainly not securitized. Given the current state of the mortgage-backed securities credit market, we are concerned that the combined effect of the limited rescission liability in Title II and HOEPA expansion in Title III will cause only those loans qualifying for the safe harbor to be made. Furthermore, if the safe harbor is constructed in a narrow manner, there may be little life in the subprime market, while regulators work out the details clarifying which loans are safe and what the process is going forward.

We understand that the theory underlying the bill is that the market will eventually price the non-safe harbor loans, but do not necessarily believe it to be a certainty. If it happens, we wonder how long it will take, how much costs will increase for borrowers, and what impact it will have on the economy.

The bill also enumerates certain objective tests for loans to qualify for the safe harbor. Although we support the general carve out for "prime" loans (i.e. qualified mortgages), we recommend the following adjustments to the criteria for "qualified safe harbor" mortgages:

- Make the debt-to-income ratio one of the alternative criteria rather than the mandatory criteria;
- Reduce the required length of fixed payments from seven years to five years;
- In lieu of restriction on margin for ARM loans, provide that the adjustable interest rate will not increase on any change date by more than three percentage points or during the life of the loan by more than seven percentage points.

Statute of Limitations

The scope of application in section 204 should be reduced. The language effectively allows a perpetual application, because it is the later of six years or foreclosure, acceleration, or the mere default by a borrower of 60 days or more. The bill allows those in a difficult financial situation to simply default on, and then try to rescind, their loans, even after years of paying them. The bill relies upon existing TILA law treatment as the foundation for the remainder of the rescission remedy. As such, for consistency sake, the statute of limitations for this section should be three years as under existing TILA section 125, with certain very limited exceptions following the initiation of foreclosure. A borrower should know within three years whether the tests are satisfied.

Other Concerns

We have an overarching concern with the lack of a role for the Federal Reserve in the rulemaking process. The Federal Reserve Board has important expertise with securitization and the secondary markets, as well as the administration of HOEPA. We believe the Fed should share rulemaking authority with the other regulators in the bill.

We also continue to believe that there should not be an outright prohibition on mandatory arbitration. Pre-dispute arbitration continues to be a far more efficient and cost-effective dispute resolution mechanism than traditional court-based litigation.

Thank you for the opportunity to raise these concerns with you. We look forward to working with the Committee to craft legislation that protects homeowners while ensuring a vigorous home finance market.

Testimony of
Donald C. Lampe
Partner, Womble Carlyle Sandridge & Rice, PLLC
Charlotte, NC

Before

U.S. House of Representatives Committee on Financial Services

"Legislative Proposals on Reforming Mortgage Practices"

October 23, 2007

Mr. Chairman, Ranking Member Bachus, Members of the Committee, thank you for the opportunity to appear here today. I am Don Lampe, a partner in the Charlotte, North Carolina office of Womble Carlyle Sandridge & Rice, PLLC. I have been involved on behalf of industry trade organizations, mortgage lenders and others, either as a legal consultant or registered lobbyist, in the enactment of state and local mortgage lending laws over the past several years, including high-cost home mortgage loan laws, in Georgia, Kentucky, Tennessee, Oklahoma, New Mexico, Ohio, Rhode Island, Minnesota, North Carolina and Montgomery County, Maryland. I have also counseled clients on the enactment and impact of new home loan laws and regulations in Colorado, California, Nevada, the District of Columbia, New Jersey, New York, Illinois, Massachusetts, Indiana, Wisconsin, South Carolina and Florida, as well as county and municipal ordinances across the country. Because much of the legislation that the Committee is considering today, i.e., the Mortgage Reform and Anti-Predatory Lending Act of 2007, is based on residential mortgage lending laws in North Carolina, I hope to be able to respond to the Committee's questions regarding our experiences in North Carolina.

Policy Choices

As a legislative body, you are faced with tough policy choices as to what you should do about what is being described as the mortgage mess, the subprime meltdown and the foreclosure crisis. As you know, Americans are looking to Congress to lead the country on a safe path through the minefield that is residential mortgage finance today. There is no denying that there have been significant disruptions in the capital markets. The capital markets traditionally have raised and channeled the majority of money that ultimately is provided to American homeowners to purchase or borrow against their homes. The capital slowdown is particularly acute in the non-conforming mortgage market, in which residential mortgage loans are originated that are not eligible for sale to the government-sponsored entities such as Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Home Loan Banks. For example, the secondary market that structures and executes private or so-called non-agency securitization transactions has been virtually inactive since summer of this year. At the same time, a higher and higher percentage of borrowers who relied in the past on getting home loans that were funded in non-agency securitizations are facing default and foreclosure. Home prices are declining around the nation, and economic leaders both within and outside the federal government are warning that the "mortgage mess" could drag our entire economy down. Our elected representatives, including many if not all members of this Committee, are hearing from constituents who are facing the devastating loss in foreclosure of their most important asset, the dwelling places of their families, their homes. With inaction not really an option to policymakers and legislators, what should be done now and what impact will these legislative choices have on consumers?

Given how quickly the subprime mortgage crisis unfolded this year and the complexity of the issues - keeping in mind that residential mortgage loans typically involve at one end an unduly complicated set of disclosures, documents and procedures that few homeowners understand, and international financial markets at the other, with many financial and regulatory intermediaries in between – it is difficult to discern between cause and effect. There appears to be consensus that the problems today resulted from an overabundance of subprime loans being made to borrowers who didn't understand them and ultimately were not able to pay them back. Too many credit-challenged borrowers obtained subprime loans that contained built-in risky features such as 100% loan-to-value, initial teaser rates, prohibitive prepayment penalties and negative amortization. In too many instances, these unfortunate borrowers were put into home loans by mortgage "salesmen," without regard to income or assets of the borrower or basic verifications. This is the numerator that troubles all of us today, consumers in distress, and it is at the very heart of the subprime meltdown and the foreclosure crisis.

The Market as a Whole

But it remains important to remember the denominator. That is, even as default rates reach or even exceed historical highs, the great majority of American homeowners will remain financially secure in their homes. For example, even at their over-exuberant peak, subprime loans constituted 20% of the overall mortgage market, up in 2005 and 2006 from a percentage of less than 10% in previous years. This body must be very careful not to over-regulate into an already fragile market. Simply stated, new legislation should not now make it all the more difficult or costly for tens of millions of Americans with good credit, existing ties with their financial institutions and the desire to own and build wealth in their homes from obtaining mortgage credit. Moreover, households facing default and foreclosure should not be cut off from obtaining non-conforming mortgage loans that may actually help keep them in their homes. That is, borrowers who unwittingly obtained or had pressed upon them subprime mortgage loans that they did not understand and could not afford deserve opportunities to refinance out of those loans, as *alternatives* to foreclosure. Federal legislative activity that impairs the ability of borrowers to obtain new and potentially more favorable loans, as loans such as 2/28's and 3/27's mature and become payable in ever-increasing numbers, would not appear to be the right approach in these times.

Obviously, if lawmakers can pin down the cause of the effects that are plaguing us today (failing markets, lender bankruptcies, illiquidity for new mortgages, defaults, foreclosures, disparate impacts on minority populations, and increased community burdens), it should be a straightforward matter to enact legislation that addresses the causes and ameliorates the effects. However, it is difficult to discern such a design in the legislation before this Committee today. If enacted, the broad limitations and unprecedented legal risk-shifting mechanisms in this legislation could lead to little relief to those homeowners suffering now and to unintended negative consequences to other Americans who look forward to accessing what has been for many years the most favorable home ownership market in the world.

Three Concerns

In the brief time that I have, I would like to make three points that, in my view, bear additional attention by this Committee as you consider this legislation. These points are built around a central theme: first and foremost, it is critically important that any legislation achieve the appropriate balance between providing strong and effective consumer protections while preserving access for consumers to fairly priced, nondiscriminatory, lawful and appropriate mortgage credit. The three points are as follows.

1. The legislation applies across the board to ALL residential mortgage loans, and seeks to re-engineer the terms of home mortgage credit, the processes for granting of it and ultimately its availability to deserving homeowners. While there may be agreement that unfair mortgage lending practices, particularly when coupled with higher-priced or risk-layered consumer mortgage products, cannot be condoned and should be legislated out of existence, it is far less clear that ALL borrowers of ANY loan secured by their dwelling need or want additional, across-the-board legal and regulatory restrictions on getting mortgages. Examples of how the legislation seeks to restrict ALL mortgage loans include:

- A "duty of care" on mortgage loan originators in every mortgage loan transaction that conforming (non-subprime) borrowers may well find unfamiliar and unwieldy. These provisions seem to assume that the average homeowner has little idea of the loan that he or she may need for his or her own personal situation and in effect may force the lender to guide the borrower through a process that is wholly unnecessary under the borrower's circumstances.

- Yield spread premiums are banned across the board, even though more informed borrowers may wish to shop around and get a conforming (non-subprime) loan in which mortgage broker compensation is calculated into the interest rate.
- The legislation in effect mandates full-blown verifications and mandatory federal law underwriting for all mortgage loans. For example, the benefit of a particular consumer having a longstanding relationship with a bank or other financial institution, and the ability of that institution to use state-of-the-art loan delivery systems to help its long-time customer quickly and efficiently get a loan, could be seriously impaired by the legislation. As far as we know, this apparent micro-management of mortgage loan underwriting is unprecedented in federal law.

2. The legislation seeks to create legal "outs" in the form of subjective conduct standards coupled with limitations on remedies, as well as price-based and "safe harbors." This approach is designed, it appears, to mitigate legal risk to loan originators and loan purchasers (assignees) in certain circumstances. This approach assumes that avoidance of litigation risk, rather than prudent yet flexible lending standards, should drive market conduct. Responsible, compliance-oriented lenders, the likes of which we would like to see more of in the market, find litigation to be an anathema and have no desire to build compliance policies and procedures simply on choices that minimize damages in lawsuits. For example, there is an evidentiary presumption that is rebuttable as to whether the mortgage loan originator has complied with the law, if the mortgage in question meets certain mathematical measurements based on the cost of the loan. First, setting aside how complicated these mathematical calculations may be in

practice, the law here requires that a number of subjective, "reasonable" standards be met. Ordinarily, the ultimate factual determination of whether a party acts in a "reasonable" manner is for a jury or a judge. Furthermore, presumptions and the rebutting of presumptions ordinarily is the business of lawyers in a courtroom, as part of putting on and objecting to evidence in a trial. Here the legislation is intended to provide comfort (if not certainty) to responsible, compliance-oriented mortgage lenders. But the assurance provided in the legislation is not that the efforts of responsible lenders will keep them out of court; rather, it is that responsible lenders will have a better chance of winning once they get there. Likewise, it may be thought that "safe harbors" for the liability of securitizers will not adversely affect the secondary market. However, the subjective standards and "safe harbors" serve to shift legal risks in subsequent proceedings and do not appear to reduce the chance that the parties to the typical secondary market transaction will not wind up in court in the first place.

3. Ironically, in pointing away from flexibility and innovation in the mortgage market (because after all isn't that how we got into this mess?), the legislation may be at odds with accepted mandates of fair lending and non-discrimination in mortgage lending. After all, flexibility of lenders, who increasingly utilize automated underwriting systems in order to help eliminate bias in lending, has benefited minorities and other protected classes of homeowners and homebuyers. At one time in history, too many lenders knowingly discriminated based on the "suitability" of particular home mortgage borrowers, using factors at the time that seemed "reasonable" and "in good faith." Today, such rationalizations in the name of discrimination are totally unacceptable. Yet the legislation appears to mandate subjective determinations based on a list of factors that must be considered to the detriment of other factors that could actually benefit a particular borrower. For example, a fair lending regulation in California states:

> "7109.3. Payment-to-Income and Debt-to-Income Ratios.
> Financial institutions should review their underwriting rules with respect to payment to income ratios or installment debt to income ratios to reflect the increasing percentage of income that must be devoted to housing expense. Overly restrictive or inflexible payment to income ratios may discriminate against low- and moderate-income persons who often must devote a greater percentage of their income to basic necessities such as housing. Any payment to income ratio should be applied with flexibility to allow for a case-by-case determination."

Similarly, the FDIC's Fair Lending Guidelines state that overly restrictive downpayment or income requirements may lead to discrimination. And the listing of mandatory factors in the legislation that must be considered in determining a borrower's "ability to repay" may discourage borrowers who do not have "standard" credit histories and W-2 income sources from getting mortgage credit. As to lending practices that led to the subprime debacle, if minorities have been overly marketed-to and disproportionately placed in unfair and unaffordable subprime loans, the situation may not be reversed if even fewer fair, reasonable and affordable credit choices are available to all borrowers in the future.

High Cost Home Loans

In closing, I would like to make two comments on (1) the impact of high-cost home loan laws, and (2) the value of a single federal standard in a comprehensive federal mortgage lending reform law. The legislation seeks to amend the federal high-cost home loan law, known as HOEPA. It is important to note that any federal law that amends existing HOEPA likely will be diminish the availability of credit. Hardly anyone, if anyone at all in the secondary market, makes, funds or purchases HOEPA loans. So, if Congress elects to amend HOEPA to cover more loans by expanding the loan types subject to the law or by lowering APR or "points and fees" thresholds or triggers, those loans in all likelihood will not be made. In effect, "how low to go" with coverage thresholds or triggers is very important. Our experience with the existing

HOEPA law and similar state laws, including North Carolina's groundbreaking high-cost home loan law, is that the thresholds or "triggers" in these laws form usury ceilings. I believe you should be mindful of this nearly certain impact of the high-cost home loan portions of the legislation.

Finally, substantive portions of the legislation before us do not appear to establish federal law as the primary mortgage regulatory regime. Instead, it appears to leave to the states the ability to enact conflicting or additional laws dealing with the same subject matter. Though we have not had much time to study the bill, I believe it would make sense for Congress to consider whether consumers and lenders alike are better served by the relative simplicity and uniformity of central, unifying federal standards in comprehensive mortgage law reform.

Again, thank you for having me here today. I am happy to answer any questions.

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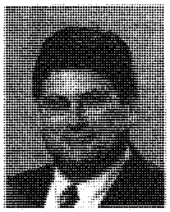

Donald C. Lampe (Don)

Charlotte
Greensboro

Profile
Don Lampe is a member of the Firm's Regulatory, Compliance and Consumer Credit Practice Team within the Capital Markets Practice Group. He splits his time between the Charlotte and Greensboro, NC offices of the Firm.

His practice includes compliance counseling, administrative and legislative matters, product development (including electronic delivery and e-commerce), litigation and enforcement and complex financial transactions (such as RESPA joint ventures) for some of the nation's largest banks and bank holding companies, thrifts and thrift affiliates, insurance companies, finance companies, technology companies and other financial service providers, as well as trade groups and industry organizations. He has significant experience in government enforcement actions, serving as counsel to industry respondents in actions brought by state and federal regulators. He has written and lectured widely on current financial services topics such as financial privacy, federal preemption, fair lending and state consumer protection laws.

He has designed multi-faceted compliance programs involving consumer privacy, information security and electronic commerce. He has years of experience in matters of federal preemption and challenges of financial services providers posed by the interplay of federal and state laws. He regularly advises creditors, loan servicers, collection agencies and secondary market participants on multi-state licensing regulations and substantive credit regulations across the country. He has worked with banking and vendor clients over the years on regulatory and business aspects of payment systems, electronic funds transfers and deposit products. Recently, he has led teams of Firm attorneys as diligence counsel in a number of complex corporate acquisition and sale transactions.

For the last several years, he has been involved extensively in legislative and administrative initiatives on the state and federal level to regulate predatory lending, "payday" lending and other types of consumer financial products, as well as financial privacy. Don has served as counsel on high-cost mortgage lending issues to several national lending trade groups, as well as counsel to or registered lobbyist for state lending trade groups in North Carolina, Georgia, Kentucky, Tennessee, New Mexico, Oklahoma, Ohio and Minnesota. He is author of the "Georgia Fair Lending Act Compliance Toolkit" (published by the Georgia Bankers Association), the "Kentucky High-Cost Home Loan Compliance Toolkit" (published by the Kentucky Bankers Association), the "South Carolina High-Cost and Consumer Home Loans Act Compliance Toolkit" (published by FirmLogic, LP), and the "Ohio Homeowners Protection Act Compliance Toolkit" (published by Argus Growth Consultants).

Professional Activities
Bar Associations: American Bar Association, Chair, Consumer Financial Services Committee; Predatory Lending Task Force. North Carolina Bar Association: Real Property Section Council, 1997-2001; Business Law Section.

Fellow and Board of Regents, The American College of Consumer Financial Services Lawyers; Governing Committee, The Conference on Consumer Finance Law; Board of Advisors, UNC School of Law Center for Banking and Finance; Steering Committee, Mortgage Bankers Association of America State Legislative and Regulatory Committee; Legislative Research Commission of the North Carolina General Assembly, Credit Insurance and Mortgage Credit Committee, 2000; North Carolina Secretary of State's URPERA Advisory Committee, 2004; Mortgage Bankers Association of the Carolinas Legislative Committee; North Carolina Bankers Association; "The Best Lawyers in America"; North Carolina Super Lawyer (Financial Institutions); Chambers USA Leading Lawyers (Financial Institutions); Duke University School of Law, Law Alumni Association Board of Directors, 1999-2002.

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Partner, Smith Helms Mulliss & Moore, LLP, Greensboro, North Carolina, October 1985-March 2002; Associate, Akin, Gump, Strauss, Hauer & Feld, Dallas, Texas and London, England, June 1982 & October 1985; Summer Law Clerk, Sidley & Austin, Washington, D.C., 1981; Summer Law Clerk, Akin, Gump, Strauss, Hauer & Feld, Dallas, Texas, 1980.

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Event[s]

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- Lampe Speaks at LSSG Lunch & Learn »
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Statement of

Kurt Pfotenhauer

Senior Vice President for Government Affairs & Public Policy

Mortgage Bankers Association

Before the

Committee on Financial Services

United States House of Representatives

October 24, 2007

Hearing on

H.R. 3915

"Mortgage Reform and Anti-Predatory Lending Act of 2007"

Chairman Frank, Ranking Member Bachus and Members of the Committee, my name is Kurt Pfotenhauer and I am Senior Vice President for Government Affairs and Public Policy for the Mortgage Bankers Association (MBA)[1]. I appreciate the opportunity to testify before you today to discuss the "Mortgage Reform and Anti-Predatory Lending Act of 2007" (H.R. 3915) which was introduced just two days ago.

Before I begin, let me thank you Chairman Frank and Ranking Member Bachus for the work you and the Committee have done to offer comprehensive approaches to address problems in the mortgage market. MBA shares your goal of stopping predatory lending. Members of the MBA have long supported the establishment of a uniform national standard as the best means of protecting consumers, providing them the widest array of financing options and lowering their housing costs.

We also greatly appreciate the efforts you and members of the committee have taken to involve MBA and other industry and consumer representatives in the effort to develop these proposals, and we look forward to working with you as the process goes forward. We think that H.R. 3915 takes important steps in the direction of providing a comprehensive set of protections for borrowers.

Nevertheless, we believe that H.R. 3915, as currently drafted, has fundamental flaws that need to be resolved. These include, first and foremost, the lack of preemption of state and local laws, as well several other problems detailed in this statement which will have the unintended effect of cutting off financing options for creditworthy borrowers. We look forward to working with the Committee to address these problems in earnest to develop a bill that can receive MBA's support.

Introduction

Today's hearing is being held during a period of great challenge for the mortgage market. A cooling real estate market and other economic factors have combined to increase mortgage delinquencies which, in turn, have created profound difficulties for many borrowers seeking mortgage credit.

In getting to where we are today, there clearly is enough blame to go around – blame for real estate sales persons and builders, for mortgage brokers, for lenders, for securitizers, for attendant settlement service providers and for some borrowers themselves. The overheated real estate sales market of the past several years increased housing costs and necessitated new mortgage products. Some mortgage brokers and others favored particular products for purchases and refinances that have not proven advantageous for some borrowers. Some lenders compromised sound

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field.

underwriting standards in the face of competitive pressures and a voracious investor appetite for loans. Some borrowers and many investors entered into financing arrangements that assumed continued appreciation and/or unrealistic future earnings. Some "bad apples" across the industry saw the market as an opportunity to make a quick buck, sometimes even by defrauding borrowers and lenders.

We believe that a critical examination of the past, along with a careful look at the reactions of the market and the regulatory framework to date, will help Congress shape a law that will avoid past mistakes without choking off credit. Some problems demand legislative solutions and some have been solved or are being solved in the marketplace already. If we do not perform our task carefully, I am afraid we will harm the continued ability of the real estate finance industry to address the financing needs of borrowers, especially those who are underserved.

Over the last three quarters, based on MBA's National Delinquency Survey data,[2] delinquencies and loans in foreclosure have increased in all sectors of the mortgage market, particularly as a result of record rates for both delinquencies and foreclosures in key Midwestern states owing to job losses. Increases in delinquencies and foreclosures have been greater in the subprime market, particularly for adjustable-rate mortgages (ARMs).[3] In some states, a significant number of delinquencies and loans in foreclosure involve investor properties. As a result of loan performance, lenders and borrowers are facing a "credit crunch" resulting in a notable decrease in liquidity in the Alt. A, subprime and jumbo[4] market sectors. Fannie Mae and Freddie Mac continue to purchase and securitize a large share of the conventional and conforming mortgages,[5] but they provide little liquidity to the subprime sector of the market.[6] Although the Federal Housing Administration (FHA) is working to help borrowers, including those facing difficulties, FHA admits that it can only serve a portion of those in trouble. At this time, jumbo borrowers' mortgage rates are carrying a greater premium than usual over prime rates but liquidity is available for that segment of the market.

There is strong evidence that lenders are underwriting mortgages much more carefully as a result of market pressures and current regulatory guidance. Guidance issued by federal financial regulators earlier this year detailed expectations regarding

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[2] National Delinquency Survey, Mortgage Bankers Association, (Sept. 6, 2007). The delinquency rate for the second quarter of 2007 for one-to-four unit residential properties stood at 5.12 percent of all loans outstanding on a seasonally adjusted basis, up 28 basis points from the first quarter and up 73 basis points from one year prior. The delinquency rate does not include loans in the process of foreclosure.

[3] *Ibid*. There is a clear divergence in performance between fixed rate and adjustable rate mortgages; the seriously delinquent rate for prime fixed loans was essentially unchanged from the first quarter of the year to the second, and the rate actually fell for subprime fixed rate loans. That rate increased 36 basis points for prime ARM loans and 227 basis points for subprime loans.

[4] Jumbo loans are loans with amounts higher than the current conforming loan limit for Fannie Mae and Freddie Mac, which is currently $417,000.

[5] Mortgage Market Note: Portfolio Caps and Conforming Loan Limits, Office of Federal Housing Enterprise Oversight (Sept. 6, 2007). Fannie Mae's and Freddie Mac's combined market share exceeded 50 percent of the mortgage-backed securities issued as of July 2007.

[6] James B. Lockhart III, Director OFHEO, at the Exchequer Club of Washington, Washington, D.C., July 18, 2007. The Enterprises' total book of business through the first quarter of 2007 included $4.5 trillion in mortgage-backed securities, $170 billion of which was subprime.

underwriting, risk management and consumer protection regarding "nontraditional"[7] and subprime mortgages.[8] The guidance initially applied only to federally regulated institutions. Subsequently, as recommended by associations of state regulators, the Nontraditional Guidance has been adopted by 40 states and the District of Columbia and the subprime statement has been adopted by 26 states and the District of Columbia.[9] As a consequence of these factors, low-documentation lending, as well as short-term hybrid ARM and interest-only products are reported to be far less available in the subprime market. We understand loans are not being underwritten to teaser rates.

Mortgage originations have declined as the real estate market has cooled, although interest rates remain historically low. Consumers continue to be served by a range of loan originators who are subject to varied licensing requirements.[10] The prime market is characterized by a wide array of originators and competition; the subprime mortgage market is characterized by a greater presence of mortgage brokers.[11]

The mortgage process remains opaque. Both sets of regulatory guidance addressed consumer disclosures for nontraditional and adjustable products at the time of origination and during loan servicing. These issuances were accompanied by suggested consumer illustrations. The Department of Housing and Urban Development (HUD) reports that it is developing improved Real Estate Settlement Procedures Act (RESPA) disclosures and that a rulemaking is imminent. The Federal Reserve Board (FRB) has indicated that it plans to improve consumer disclosures under the Truth in Lending Act (TILA) as well. MBA believes that a law should be enacted requiring comprehensive simplification of federal and state disclosures.

Generally, the nation's more than $3 trillion mortgage industry has done an outstanding job for consumers and the larger economy. It has been a driving force in establishing communities, fueling the economy and building wealth for America's families. Over the last several years, our industry has helped our country achieve a near 70 percent homeownership rate.

In sum, abuses and delinquencies cannot be allowed to eclipse the achievements of the market and undermine its ability to respond to consumer needs in the future. To assure the market's continued health, we must guard against any legislative or regulatory solutions that are not based on a sound understanding of the market and that have the

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[7] 71 F.R. 58609 (October 4, 2006).
[8] 72 F.R. 37569 (July 10, 2007).
[9] The Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) both adopted the Guidance on Nontraditional Mortgage Product Risks on January 31, 2007 and the Subprime Statement on July 17, 2007. Several states have since added both provisions' language to their own regulations so that it applies to institutions they regulate.
[10] Mortgage bankers and mortgage brokers play different roles in the market. For example, mortgage brokers act as intermediaries and arrange loans for borrowers from lenders, while lenders purchase loans originated by mortgage brokers and act as loan "wholesalers" and/or originate loans themselves directly for borrowers through their own retail sales force.
[11] John M. Reich, Director Office of Thrift Supervision, before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, Washington, D.C. March 27, 2007. Some estimates reported by OTS say that 70 to 80 percent of all subprime mortgages were originated by brokers.

potential to undermine the market's benefits going forward – particularly for those in most in need of credit.

MBA's Core Principles in Reviewing Lending Legislation
Before we examine H.R. 3915, please allow me to share with you our core principles which are as follows:

- **First, and Foremost, Any New Law Must Establish a Truly Uniform National Standard.** As I have indicated, MBA maintains that for a uniform national standard to have our support, it must be both preemptive and set forth objective and clear standards. Specifically, MBA believes that any bill that we support must contain an unequivocal preemption of all state and local laws. No matter how well intentioned, those who advocate that a federal law be a floor – to be supplemented by state laws above and beyond its provisions – the plain fact is that the current patchwork of state and local laws only increases costs for consumers across the market. To add a new federal overlay without subsuming current laws will only add confusion and costs. A patchwork of laws is a barrier to the entry of competitors and an enormous compliance burden on those who compete. The appropriate state role under new legislation should be to assist with the enforcement of new requirements and not to duplicate or contradict them.

  Final legislation must also contain clear and objective, bright-line standards that protect borrowers. Vague standards invite litigation, lessen competition and increase costs. While we recognize that to achieve preemption any new law must comprise a "gold standard" of protections, we believe that result is achievable, as long as the law is both preemptive and clear.

Any new law must also:
- **Preserve the Availability of Credit Options Across the Credit Spectrum.** The prime mortgage market is functioning smoothly and the Alt. A market does not function like the subprime market. Any new legislation, therefore, should only address the problems associated with the subprime mortgage market and not unduly impact the rest of the market. In this connection, MBA believes that any definitions of "prime" and "subprime" embedded in law must work to ensure that prime, Alt. A, FHA and Department of Veterans Affairs (VA) loans are not inadvertently covered. Also, the law should require that regulators periodically revalidate any such definitions to assure that only subprime loans are addressed.

- **Assure the Continued Ability of the Secondary Market to Provide Capital for All Borrowers.** The advent of an active secondary mortgage market following the Great Depression resulted in lower borrowing rates for consumers during both up and down credit cycles. In including any provisions that may assign new liability to the secondary market, legislation must be fashioned to assure that it does not unduly cut off liquidity and the benefits it brings to borrowers. In MBA's view, a preferable approach to address abuses is to stem them where they occur, in the subprime origination market. If it is the intention of Congress to place responsibility on securitizers to act as reviewers of origination practices, then care must be taken to assure that any new requirements are well defined and well targeted to avoid causing a flight from investment in mortgage assets and higher costs for borrowers.

- **Recognize that, Given Current Market Conditions, Actions Must Be Avoided that Will Further Seize Credit.** As indicated, recent increases in delinquencies have resulted in a lack of credit to subprime borrowers and others across the credit spectrum. Of particular concern is the unavailability of credit to borrowers with adjustable-rate mortgage products that reset, who face significantly higher interest rates and monthly payments, and who are seeking or will soon seek to refinance. While FHA and others are attempting to serve these borrowers, it is clear that the subprime market will also be needed to serve them. Any legislation must not unduly impair the mortgage industry's ability to provide these borrowers good subprime credit options and not strand them in products which they can no longer afford.

- **Avoid Unreasonable Litigation Costs to All Consumers While Assuring Consumers Have Appropriate Remedies.** Remedies under any new bill should provide individual consumers strong and effective redress for any abuses that violate bright-line standards. If the remedies are well conceived and tough, they will deter violations from occurring. On the other hand, if the type of conduct proscribed is vague or undefined, or if the remedies invite broad class actions and excessive damages, the effect will only be to limit competition, and curtail investor interest. Such a result will provide windfalls for litigators and much higher costs for borrowers.

- **Preserve Flexibility So that the Industry Can Continue to Innovate and Respond to Changing Borrowers' Needs.** While much has been written about lenders providing "exotic mortgage products," for many borrowers these products proved to be an effective means of navigating high home prices. In recent years, the industry also innovated to create the 40-year mortgage, the 15-year mortgage, the reverse mortgage, the home equity line of credit (HELOC) as well as a variety of low-down payment products. Housing affordability remains a challenge for many borrowers. Any new law must foster and not frustrate continued innovation to respond to changing borrower needs.

- **Preserve an Atmosphere that Allows Diverse Business Models and Structures that Give Consumers Greater Choices and Competition.** A key feature of the American mortgage finance system has been the variety of loan providers that compete for borrowers' business including: lenders (both depository and non-depository and both federally and state chartered); mortgage bankers; credit unions; and mortgage brokers. Any new law should further and not frustrate the continued diversity of the market.[12] At the same time, MBA believes it is essential that the law make appropriate distinctions to address regulatory needs.

It is clear, for example, that a mortgage broker functions differently than a lender and differing requirements for each are appropriate. A borrower views the broker as shopping on the borrower's behalf, which is not the case with a lender.[13] At the same time lenders and their employees are one and the same and offer products to borrowers that borrowers can shop and compare. MBA therefore believes it may be unnecessary and unwise for legislation to reshape lenders' compensation models for their own employees.

- **Improve Transparency and Consumer Understanding of the Mortgage Process.** MBA has long advocated that the mortgage process is far too complicated and that improvement of consumer disclosures would help stem lending abuse. Consumers today face a pile of disclosures when they apply for and close on a mortgage. Improved disclosure would allow consumers to compare loan products and facilitates market competition to lower costs. On the other hand, too many disclosures or the wrong kinds of disclosures are counterproductive and allow abusers to hide in plain sight.

  MBA notes that HUD and the Federal Reserve Board are working to improve disclosures under RESPA and TILA respectively. Others are calling for a one-page simple form. MBA favors coordination of all of these efforts and a comprehensive approach to streamlining the mortgage process.

Comments on H.R. 3915

As indicated, MBA shares the goal of devising strong, workable legislation that provides clear, objective and balanced standards to protect consumers against predatory lending without hampering the ability of the market to innovate and provide financing options for borrowers. Also, as indicated, we provide comments on H.R. 3915 in that spirit.

As a preliminary matter, H.R. 3915 does not establish a uniform national standard. It does not preempt state and local laws nor does it consistently provide clear and objective standards. The latter point is discussed further in comments to follow. MBA would only support legislation that truly creates a uniform national standard.

The following discusses MBA's concerns with provisions of H.R. 3915 along with MBA's recommendations for improvements:

[12] For 2006, 8,886 institutions including 3,900 commercial banks, 946 institutions, 2,036 credit unions, and 2,004 mortgage companies, reported under HMDA. The National Association of Mortgage Brokers reports 53,000 mortgage brokerage companies, as of 2004, employing an estimated 418,700 people.
[13] Letter dated January 14, 2002 to the Honorable Mel Martinez.

TITLE I
Licensing and Registration
MBA supports national licensing of mortgage originators as well as the creation of a registry that tracks them. This bill would require that states enact licensing laws that meet certain prescribed standards or, after 24 months, beginning on the date of enactment, be subject to a more onerous federal standard to be developed by HUD. In this connection, MBA strongly objects to the directive that HUD regulations shall require a mortgage originator to act solely in the "best interest of the consumer." Lenders owe duties to their stockholders and investors; they cannot at the same time feasibly assume countervailing duties to borrowers. Just as importantly, such a standard would require lenders to undertake an impossible search for the "best terms," ultimately requiring that the lender meet what amounts to a "suitability standard." As such, the provision invites litigation and higher costs for borrowers.

MBA believes that without establishing clear reciprocity requirements the licensing regime under H.R. 3915 would be unworkable. Lenders would be required to pay the licensing costs of several states (sometimes nearly every state) and would be required to comply with individual state licensing requirements. Clear reciprocity, on the other hand, would permit an originator licensed in one state to be licensed in other states. Such an approach would ensure that originators are trained and comply with fundamental requirements and, at the same time, allow them to operate and compete across the nation.

Finally, with respect to the licensing provisions, MBA believes that the exception for licensure of individual originators applicable to depository institutions should be expanded. It should also cover individual originators employed by companies that are: FHA-approved Direct Endorsement lenders, Fannie Mae or Freddie Mac-Approved Sellers, or maintain a net worth equal to or greater than $25,000,000. Companies that already comply with rigorous requirements for their employees should not be required to license them individually.

Duty of Care
MBA supports a duty of care approach that requires lenders and mortgage brokers to present to the consumer a finite range of loan products for which a borrower might qualify following final underwriting, along with the comparative costs and benefits of the products. This type of information should be given after the borrower provides basic information about himself or herself and the location of the property, less than would be required for an application. In that way, the borrower would be given information early in the process to allow him or her to shop and choose the best mortgage. MBA would also support other requirements as part of a duty of care, including that: the lender be qualified, licensed and registered as an originator, and the originator disclose the nature of the originator's relationship with the consumer, along with the originator's unique identifier. H.R. 3915 appears to adopt some of this approach but the timing of the disclosure and its conditional nature must be clarified. In any case, this approach is far preferable to the establishment of a subjective, vague, suitability type standard. While MBA generally supports this approach, we are concerned that without clarification this

section could inadvertently trigger the application of other mortgage related statutes and regulations such as the Fair Credit Reporting Act. We think the legislation should clarify that this is not the case.

Under this provision, MBA believes mortgage brokers would be required to disclose to a consumer whether they will or will not act as the consumer's agent. MBA supports this approach. We also believe mortgage brokers should disclose the amount of any compensation they receive from the lender or borrower.[14] Mortgage brokers function as intermediaries to shop for borrowers, and borrowers working only with brokers cease shopping for themselves. The payment from a lender to the broker should be known to the borrower because it affects the borrower's rate.

Lenders, on the other hand, are vendors selling their own loan products. Loan officers are the lender's representatives and neither they nor lenders hold themselves out as shopping for borrowers. Borrowers shop and compare lenders' costs. For these reasons, MBA believes that it is appropriate for brokers to disclose any fees from lenders. Also, if a broker indicates that it is an agent of the borrower, it should be required to act as such, as the bill suggests in Section 102.

Anti-Steering

H.R. 3915 would prohibit the paying or receiving of incentive compensation to any mortgage originator, directly or indirectly, that is based on or varies with the terms of any residential mortgage loan without differentiating between mortgage bankers and brokers. As context to our comments on this approach, we would like to discuss further the stark functional differences between mortgage lenders and mortgage brokers.

The delivery channels through which borrowers obtain loans vary considerably. In many cases, lenders originate mortgages through their own loan officers or correspondents in response to loan applications submitted through the Internet, call centers, by mail or a visit to a lender's office. Others obtain mortgages originated by mortgage brokers. While there is not definitive data on the breakdown of lender and broker originated loans, it is estimated that mortgage brokers originate more than 50 percent of all loans[15] and 70 to 80 percent of subprime mortgages in any given year.[16]

Some borrowers shop effectively among the range of mortgage originators. Others rely on mortgage brokers to shop for them. Following a hearing concerning mortgage

[14] Since the early 1990's, following the advent of mortgage brokers, HUD has required that yield spread premiums to mortgage brokers in table funded transactions be disclosed to the borrower as settlement costs. In its 2002 proposed RESPA rule, withdrawn in 2004, HUD sought to make the disclosure clearer than the current requirement which permits disclosure on a notation on a list of fees as (YSP POC or yield spread premium paid outside of closing).

While a lender also may receive compensation based on a loan's yield by investors in the secondary mortgage market, HUD has not required the disclosure of these payments to lenders. Where lenders receive such payments, they are not obtained at settlement. Moreover, many lenders portfolio their loans and do not receive such payments.

[15] Harry Dinham, President of National Association of Mortgage Brokers (October 18, 2006) Study Reveals Brokers Are Less Costly Option For Sub-Prime Borrowers. New Study Finds Factual Evidence that Consumers Pay Less with a Broker <http://www.namb.org/namb/NewsBot.asp?MODE=VIEW&ID=149&SnID=1807988655>. Press release.

[16] See footnote no. 12.

broker compensation on January 8, 2002, Senator Paul S. Sarbanes noted "a borrower's relationship with a mortgage broker is clearly different than with a lender. A borrower views the broker as shopping on the borrower's behalf, which is not the case with a lender."[17]

Loan officers, lenders and brokers may receive compensation based on the rate of the loan that the consumer enters into in addition to fees from the consumer. However, since brokers act as intermediaries and cause consumers to stop shopping and lenders and loan officers are vendors whose prices are shopped and compared, MBA believes it is appropriate for the law to distinguish between lenders, loan officers and mortgage brokers in fashioning anti-steering provisions.

MBA might support a provision forbidding brokers from receiving compensation based on the terms of a loan. MBA believes a better approach, however, is to require full disclosure of a broker's compensation when the borrower is shopping for a loan. MBA notes that H.R. 3915 permits borrowers to "finance" origination fees if such fees are fully disclosed to the consumer early in the application process and do not vary based on the consumer's decision whether to finance such fees. This provision should be clarified to expressly permit the use of yield spread premiums (YSPs) to defray some or all of the borrower's closing costs through a higher interest rate as well as financing these costs. Not clarifying this point would have a deleterious affect on the ability of cash poor borrowers to pay closing costs through a higher rate and monthly payment if they so choose.

Finally, in connection with steering, MBA opposes H.R. 3915's directive to regulators implementing the anti-steering regulations that the regulations "seek to ensure" that they promote the interest of the consumer in obtaining the "best terms for a mortgage loan for which the consumer qualifies." Such a directive may require establishment of a subjective standard that is likely to be impossible to achieve, and invite litigation, liability and higher costs for borrowers. Instead, MBA believes that regulations in this area may be workable if they require that the regulators' implementing regulations provide bright-line standards and safe harbors to clarify what is required.

TITLE II
Ability to Repay/Net Tangible Benefit
Prudent underwriting is the cornerstone of responsible mortgage lending. Lenders have every incentive to properly underwrite a borrower's ability to repay a mortgage loan. In the event that a loan fails, a lender may be forced to repurchase the loan, investors may decide to no longer do business with the lender and the lender's reputation will suffer in the community. For these reasons and more, lenders take great care in considering and evaluating a consumer's ability to make their mortgage payments – across all segments of the market.

MBA would support clear and objective requirements that originators determine a borrower's ability to repay and that a loan provide the borrower a net tangible benefit

[17] Letter dated January 14, 2002 to the Honorable Mel Martinez.

provided the rules also recognize the dynamism of the market and allow legitimate lending to continue.

H.R. 3915 establishes two safe harbors based on North Carolina's definition of a rate spread loan. The law uses the difference between an annual percentage rate for the loan and the yield on U.S. Treasury securities having comparable periods of maturity equal to or greater than – (1) three percentage points from U.S. Treasury securities for first liens, or (2) five percentage points if the loan is secured by a subordinate lien.[18]

Loans below these thresholds are considered prime loans and are presumed under H.R. 3915 to meet the ability to repay and net tangible benefit requirements. MBA supports this exception as far as it goes but believes similar exceptions should be fashioned for FHA and VA loans. MBA also is concerned that the statutory formulae may not capture the whole prime and Alt. A market. For this reason, MBA believes H.R. 3915 should require that the regulators initially and periodically revalidate these formulae to assure that the safe harbor for prime and Alt. A loans includes these loans as intended.

Loans above the threshold are subject to ability to repay and net tangible benefit standards – which can be satisfied if certain "safe harbors" are met. These loans are referred to as "qualified safe harbor mortgages." The law requires that for "safe harbor mortgages" to meet the "ability to repay" and "net tangible benefit" standards loans must have (1) documented consumer income; (2) an underwriting process based on a fully indexed rate taking into account taxes and insurance (3) debt-to-income ratio not greater than 50 percent or some other percentage prescribed by regulation; (4) no negative amortization (5) other requirements that may be established by regulation; and either (6) fixed payment over at least 7 years; or (7) for an adjustable loan an APR that varies based on a margin that is less than 3 percent over a single generally accepted interest rate index that is the basis for determining the rate of interest on the mortgage.

MBA believes these "safe harbors" are in actuality a new set of underwriting standards. As such, these standards will unnecessarily eliminate many loans in the subprime market and possibly the prime market as well. We strongly recommend that Congress carefully consider the potential impact of these safe harbors before hard-wiring them into law.

A similar three percent trigger in HMDA captures a significant portion of the mortgage market. Data reveal that approximately $623 billion of the $2.5 trillion of mortgages originated in 2006 (according to HMDA) have interest rates that were higher than the

[18] H.R 3915, as in the North Carolina standard, correlates the APR for a loan and the conventional mortgage rate, as follows:

> "The difference between the annual percentage rate for the loan and the conventional mortgage rate is either equal to or greater than (i) 1.75 percentage points (1.75%), if the loan is secured by a first lien mortgage or deed of trust, or (ii) 3.75 percentage points (3.75%), if the loan is secured by a subordinate lien mortgage or deed of trust. For purposes of this calculation, the "conventional mortgage rate" means the most recent daily contract interest rate on commitments for fixed-rate first mortgages published by the Board of Governors of the Federal Reserve System in its Statistical Release H. 15 or any publication that may supersede it during the week preceding the week in which the interest rate for the loan is set.

300 basis point trigger that requires HMDA reporting and would be covered under this bill. Firms identified as subprime originators by HUD only accounted for about $320 billion in originations. About $14 billion of the loans with rates above the 300 basis point trigger were purchased by Fannie Mae and Freddie Mac. In addition, based on the HMDA data, about $283 billion of the mortgages made with rates covered by this bill were made to purchase homes. While the dollar amount of refinance loans was higher at $319 billion, the number of borrowers who relied on loans covered in this bill to purchase homes was larger than the number who used these loans to refinance - about 1.9 million loans to purchase homes versus 1.8 million refinance loans. MBA is willing to provide additional data as available concerning the effects of the bill.

MBA also notes, and strongly opposes H.R. 3915's formulation that the presumption that a loan that meets the safe harbor is "rebuttable" for loans above the threshold. If a loan meets a safe harbor, it should be permissible without further review. If this provision is not clarified, MBA believes it will be impossible to securitize above threshold loans, thus, depriving borrowers of the cost savings achieved by securitization.

MBA will, in any event, continue to work with lawmakers to fine-tune the safe harbors so that legitimate lending is not out of reach for qualified borrowers. MBA also has the following additional comments on each of the requirements for qualified safe harbor loans:

(1) *Documented consumer income.* MBA believes reduced-documentation or stated-income loans can be beneficial and appropriate options for borrowers regardless of the type of loan or category of loan, whether the loan is prime, Alt. A or subprime. There are various segments of the population who have difficulty documenting their income and assets, particularly with a W-2 or bank statement. Self-employed borrowers, for example, present lenders with the greatest challenges in this regard; frequently only gross business receipts are reflected on their tax returns, taking away the usefulness of these documents to show net income. MBA would recommend that if H.R. 3915 maintains a requirement for full documentation it should expressly authorize lenders to "document" income by using information in addition to W-2s, tax returns or banking statements. A lender's inability to use other documentation, such as rental receipts, bills or other relevant documents, could disadvantage some of our most credit starved and creditworthy borrowers and put homeownership out of their reach.

(2) *Underwriting process based on fully indexed rate (taking into account taxes and insurance).* The Subprime Statement and Nontraditional Guidance provide that loans, where there may be payment shock or less than full documentation or fall into defined categories, must be underwritten to the fully indexed rate and fully amortizing payment. H.R. 3915 would expand these requirements to include all subprime loans regardless of their terms. MBA believes this approach is overly broad, unnecessarily restrictive and would deprive subprime borrowers of affordable financing options. For example, it would require that an ARM loan with a fixed period of five years be underwritten to those standards even though there generally is no payment increase for five years. MBA believes that products such as these should be open to more flexible underwriting standards so that these can be made available to subprime borrowers. While MBA believes that the Subprime Statement and Guidance are restrictive, the market is adjusting to them. If H.R. 3915 seeks to convert these directives into law, it should not expand them beyond their terms.

(3) *Debt-to-income ratio not greater than 50 percent or some other percentage prescribed by regulation.* MBA objects to hard-wiring into law a 50 percent debt-to-income ratio for subprime loans for several reasons. Debt-to-income is only one factor in underwriting in today's mortgage market, and not particularly predictive of default. The performance of loans with debt-to-income ratios greater than 50 percent has been good because of other offsetting factors, including strong credit histories, other financial resources, growing income or a borrower's proven cash management abilities. The mortgage industry is dynamic. A decade ago, 28/36 debt ratios were standard in the industry. They were later found to be unduly restrictive. Had these ratios become a hard-wired legal standard, they would have prevented many current homeowners from ever enjoying homeownership. Finally, limitations on what payment or rate is used in underwriting debt-to-income ratios will have disparate effects on borrowers in different areas of the country. For example, in some markets an established borrower can look for a less expensive house requiring a smaller loan. In other, high-cost areas, good borrowers with good incomes need to stretch further since less expensive homes may not be available.

(4) *No negative amortization.* Currently, negative amortization loans are not available to borrowers meeting the HOEPA triggers and H.R. 3915 would effectively expand the requirement to subprime loans.

(5) *Other requirements that may be established by regulation.* While MBA does not object to providing additional authority to the regulators to establish additional safe harbor requirements, MBA believes H.R. 3915 should also require that any such requirements be balanced, objective and take into account the needs of consumers in obtaining mortgage finance. MBA also believes that the omission of the Federal Reserve Board from the entities regulating under key portions of H.R. 3915 is unwise. The Board occupies a unique place in and understanding of the national lending system and has long regulated the mortgage industry under TILA and HOEPA. The Board's experience is relevant and its input and participation is warranted.

(6) *Fixed payment for at least seven years.* H.R. 3915 would make the safe harbor for subprime loans only available to fixed rate loans with fixed payments for seven years or more. MBA believes that this requirement should be more flexible, and, that if Congress is to require a fixed term, it should be no greater than five years. We think the right approach here is to give the regulators rulemaking authority to make a determination based on market dynamics and the needs of consumers. If a term is chosen, however, five years would be a sufficient period to avoid payment shock and still gives subprime borrowers the option of a more affordable loan for a relatively long period of time.

(7) ***For adjustable-rate loans, an APR that varies based on a margin that is less than 3% over a single generally accepted interest rate index.*** MBA does not believe a rigid ceiling should be written into law because of the dynamism of the market. If Congress believes such a standard is necessary, the regulators should be given flexibility to develop reasonable standards with appropriate guidance and subject to ongoing review. The regulators should be permitted to explore alternative approaches such as a reasonable cap on ARM adjustments instead of tying the safe harbor to the interest rate index.

Net Tangible Benefit
H.R. 3915 would require that all refinance loans provide borrowers a net tangible benefit and leaves to the regulators the task of developing implementing requirements. MBA would consider supporting this approach provided that there were requirements that that implementing rules be clear, objective and economically-based. By economically-based, MBA means that each benefit must be amenable to computation based on objective economic values. By way of examples, these might include a lower rate of more than a specified percentage, a lower payment of a particular percentage or more, a cash-out providing a specified dollar sum or an extension of the loan term for a specific number of years or more. Vague and subjective standards should be avoided. For example, in the context of a cash-out refinance loan, a lender should not be put in a position of determining whether the intended use of the proceeds of a loan is beneficial given the borrower's situation. If clear, objective and reasonable standards are not established, it will be impossible for lenders to determine which requirements pertain; lenders will avoid the subprime market and deprive subprime borrowers of low-cost credit options.

Assignee Liability
Instituting assignee liability to correct errors in the mortgage origination process potentially threatens the availability and cost of mortgage loans. For this reason, MBA believes that if abuses arise during origination then they should be addressed in that arena.

At this point, the secondary market has every incentive to ensure the loans that it buys meet legal requirements and perform well. Investors have recently suffered significant losses. Consequently, the secondary market has significantly tightened guidelines on the loans it will buy. MBA believes this is an area where the market is regulating itself obviating the need for new legal requirements. The secondary market will reject the purchase of loans that expose it to liability and where risk cannot be offset, managed, determined and quantified. We implore lawmakers if they institute enhanced assignee liability to be careful and surgical in crafting such a standard. Otherwise, its impact could result in shutting off needed liquidity for our mortgage finance system.

Additionally, we are concerned that the scope of those who might qualify as an "assignee" is overly broad and could include entities specifically excluded under the Truth in Lending Act. Specifically, we are concerned that servicers would fall under the definition. We believe this is inappropriate given their role in the market. Servicers do not provide capital to the primary mortgage market. They perform the service of collecting payments from the borrower, making payments from escrows and remitting payments to the asset owner. To treat servicers as assignees miscomprehends their functions and is inappropriate.

Warehouse lenders also should be expressly excluded from the definition of "assignee." These entities hold the loan for a short period of time as security for their temporary advance to a mortgage banker to fund the loan. They do not ordinarily take title to mortgages. Were they to be held liable as assignees, the funding process would be unnecessarily burdened and loan costs would increase for all borrowers.

Finally, in terms of the assignee liability safe harbor, MBA is concerned that the "reasonable due diligence" prong does not adequately specify what amount or type of due diligence must be conducted to satisfy the safe harbor's requirements. The bill leaves the matter to the regulators with little direction. The standard for compliance should be objectively measurable and reasonable. The regulators should also issue rules that clearly and objectively establish compliance standards to satisfy the "reasonable due diligence" requirement as well as compliance standards for other safe harbors.

Renters and Foreclosure
MBA opposes the provision requiring that any "successor" in interest of a foreclosed property permit a tenant to continue to reside at the property for at least 90 days. Such a requirement hampers the sale of foreclosed properties – the effect of which will be to increase costs for all loans. Further, it may extend the blight on the very communities that are harmed by foreclosures. MBA strongly advises that this approach be reconsidered.

Right to Cure
MBA strongly supports the concept of the right-to-cure provisions embodied in the bill. Right to cure provisions offer borrowers an effective means of obtaining early relief without resort to litigation.

H.R. 3915 provides the opportunity to cure an error in origination 90 days from the date of notification. However, we believe the time period for cure should begin when the creditor receives notice from the assignee. The creditor will be charged by the securitizer with the responsibility to address the claim and should not be disadvantaged in its investigation by any delay in transmission of the claim from the securitizer.

Six Year Period of Liability and Defense to Foreclosure
H.R. 3915 allows consumers to exercise their rescission rights for extended periods of time - which exposes assignees to significant liability well into the life of the loan. Specifically, a borrower can make a rescission claim during the first six years of the loan. A borrower can also make a rescission claim as a defense to foreclosure over the life of the loan or where the borrower has been in default for 60 days or more. The lender does not have to initiate foreclosure or accelerate indebtedness in order to

trigger the rescission right. Instead, the borrower can assert the claim at any point that the borrower is sixty days or more delinquent, regardless of whether the lender has sought to enforce the loan's terms. This is an alarming provision that would permit borrowers to game the system. A borrower would be able to cease paying on their mortgage, make a claim to rescind the loan and forestall foreclosure.

H.R. 3915 should explicitly provide that the borrower should return to the lender the value of the principle loaned. Under such a provision, if the home value has depreciated due to economic factors or because of a failure of the owner to maintain it, the lender would not be disadvantaged. This provision is consistent with the theory behind rescission which is to put the parties back in the positions they were in before the transaction took place. The absence of these changes would significantly disadvantage the lender and allow a borrower to be unjustly enriched.

Finally, H.R. 3915 should explicitly provide that any person who encourages a borrower to default or defraud a creditor in an effort to take advantage of the rescission remedy should be penalized and held criminally accountable.

TITLE III

H.R. 3915 amends the Home Ownership and Equity Protection Act (HOEPA). The HOEPA thresholds are the functional equivalent of a usury ceiling. Lenders do not make loans that trigger HOEPA coverage. This is because HOEPA loans give rise to enhanced liability exposure including assignee liability. Expanding the scope of loans that would be covered by HOEPA means that additional loans just will not be made. Therefore, Congress should be very careful about where the triggers are set because if they are set too low it could cut off legitimate lending.

H.R. 3915 establishes three triggers that, if met, qualify a loan as a high-cost loan which carries with it significant liability; (1) the point and fee trigger under H.R. 3915 is set at five percent and includes YSPs and prepayment penalties, (2) the APR trigger mirrors current requirements at eight percent and (3) a prepayment penalty trigger.

With respect to the point and fee trigger - the effect of both lowering the point and fee trigger from eight percent which is current law to five percent - as well as including yield spread premiums and prepayment penalties, will most certainly result in cutting off legitimate lending. Lenders will not make prepayment penalties or pay yield spread premiums – which have been valuable consumer financing options.

The prepayment penalty trigger states that the charge or collection of prepayment fees or penalties more than 30 months after the loan closing or the fees/penalties exceed in the aggregate, more than two percent of the amount prepaid qualifies the loan as a high cost loan.

The option of a prepayment penalty in connection with a mortgage allows a borrower to choose a lower rate and lower monthly payments in return for agreeing not to refinance within a set period unless he or she pays a fee. A lower rate can be offered because the presence of a prepayment penalty assures a more reliable income stream for investors in pools of such mortgages and, consequently, better pricing for securities and consumers themselves.

MBA has long been committed to transparency and informed consumer choice and, in that vein, believes that prepayment penalties should always be optional and result from true consumer choice. Accordingly, MBA would support a requirement as part of a uniform lending standard that originators provide borrowers with a choice of a loan rate with and without a prepayment penalty, if available.

CONCLUSION

MBA shares the goal of enacting a uniform national standard that would provide clear protections against abusive mortgage lending for consumers while allowing the industry to provide needed credit. While we believe H.R. 3915 offers considerable promise to finally achieve such a result, we also believe that the bill as written has significant flaws.

We look forward to working with the committee to improve the bill and finally achieve our shared goal. We stand ready to assist in any way that we can.

Testimony of

Bradley E. Rock

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

And

AMERICA'S COMMUNITY BANKERS

Before the

Committee on Financial Services

United States House of Representatives

October 24, 2007

Testimony of Bradley E. Rock
Chairman, President, and CEO, Bank of Smithtown, Smithtown, New York
on Behalf of the
American Bankers Association
and
America's Community Bankers
before the
Committee on Financial Services
United States House of Representatives

October 24, 2007

Mr. Chairman and members of the Committee, my name is Bradley Rock. I am Chairman, President, and CEO of Bank of Smithtown, a $1.1 billion community bank located in Smithtown, New York, founded in 1910. I am also the Chairman of the American Bankers Association (ABA). The American Bankers Association, which represents community, regional and money center banks and holding companies, as well as savings associations, savings banks and trust companies, is the nation's largest banking trade association.

Upon completion of its merger with America's Community Bankers at the end of November, ABA will represent 95 percent of the industry's $11.5 trillion in assets, and it will speak for the vast majority of the industry's 2 million employees. At the same time, 83 percent of the new ABA's members will be community banks with less than $500 million in assets.

I am glad to be here today to present the views of the ABA and ACB on possible legislative initiatives to improve mortgage lending standards, particularly as they relate to subprime mortgages. There is no question that our country is going through a very difficult time as many homeowners struggle to meet their monthly mortgage payments. With falling home values throughout the country and a large volume of subprime adjustable rate mortgages with "teaser rates" being repriced to much higher rates, the situation is likely to get worse before it gets better.

Many forces combined to create the problems we face today. After the dot-com bust, money flowed into real estate, helping to fuel a boom in home prices. As home prices rose, non-traditional mortgage products became quite popular as an avenue for real estate investment and homeownership. In many cases, individuals were purchasing homes with the intent of "flipping" them – investing money into upgrades and then hoping to quickly sell at a significant profit. Others purchased houses as mere investment properties with the intent of renting them out to others and then selling once the property had appreciated. In other cases, loans were being made to first-time homebuyers who may not have fully appreciated or understood the terms of their loan agreement. Still others were simply cashing-out their equity by re-financing. With the frenzy that ensued, sound underwriting practices were often sacrificed – primarily by non-bank originators – for immediate gains.

The fallout of the mortgage markets has been very troubling to the banking industry – an industry filled with institutions that have existed for decades, and in the case of my bank, for nearly 100 years. It has been the actions of loosely-regulated non-bank lenders, and their fly-by-night operations, that have caused a lot of damage for consumers and for the industry. Many of these firms have already gone out of business, while others have begun restructuring their businesses. As bankers we intend to be in our communities for the next 100 years and beyond. Therefore, we know that we must be part of the solution, and we are very pleased to work with you, Mr. Chairman, and with the members of this Committee, on finding ways to bring mortgage lending practices back into balance.

While the Committee is considering legislative approaches, the banking industry has already initiated efforts to help. I know many community banks are stepping up their mortgage lending. In addition, the ABA and ACB, along with other trade groups, servicers, not-for-profit counseling agencies and investors, have formed the HOPE NOW Alliance which is dedicated to help keep Americans in their homes. The various members of the Alliance have agreed to adopt particular measures to improve process efficiency, create a sustainable funding model for quality phone and face-to-face counseling, develop standardized metrics to evaluating effectiveness, and work collectively with other HOPE NOW partners to overcome challenges that may arise. Several working groups within the Alliance are undertaking tasks designed to achieve these goals and will be meeting regularly in the months ahead to report on their progress. The Alliance encourages other industry participants to join this effort and the federal government has helped convene participants and facilitated ways to reach as many homeowners as possible and avoid unnecessary foreclosures.

Individual institutions have also taken significant steps designed to prevent the current problems from recurring in the future. For example, Washington Mutual recently unveiled a new disclosure standard that all mortgage brokers with whom it does business must follow. The standard is specifically designed to ensure that borrowers fully understand the terms of their loan agreement. It requires mortgage brokers to certify that they have disclosed to borrowers early in the application process key terms such as the loan amount, the loan term, whether the interest rate and mortgage payments may change, and whether a prepayment fee may apply.

A guiding principle for all of us should be the steadfast adherence to high ethical standards. Whether you are a banker, mortgage broker, mortgage banker, realtor, appraiser, developer, investor, or anyone involved in real estate and homeownership, high ethical standards should be the norm, not the exception. The damage caused by deceptive or unscrupulous sales practices extends beyond the consumer who is directly targeted to mortgage markets and the economy in general. As a bank, we are subjected to, and examined regularly for, compliance with a range of laws and regulations. I hold all my employees to high standards and the regulators make certain of it.

In addition to the overarching principle of maintaining high ethical standards, I would like to discuss several additional principles that the ABA and ACB believe should guide any legislative approach:

- Sound underwriting principles based on the borrower's ability to repay are needed in every mortgage loan. This will assure a vibrant market for ***any*** loan whether it be to prime borrowers or to near-prime and subprime borrowers.

- Consistent standards are needed, particularly to bring non-bank mortgage originators up to the standards applied to bank originators.

- Legislation should create as little disruption as possible for the marketplace. Extreme care needs to be taken not to saddle banks – which generally had nothing to do with the current problems – with more burdens which inevitably impede ***all*** types of lending. Moreover, access to credit at the lowest possible cost relies upon an effective and efficient secondary market for mortgages.

Mr. Chairman, while we are still in the process of evaluating the Mortgage Reform and Anti-Predatory Lending Act bill sponsored by you, Mr. Miller, Mr. Watt, and other members of your Committee, we recognize that it provides an essential starting point from which all interested parties can work. We appreciate the fact that we have been consulted on aspects of this legislative proposal. We will be having lengthy discussions with our member banks about your proposal and can provide you with additional feedback on specific components of this important legislation. Thus, what I hope to accomplish in my written statement is to lay out key principles that should be incorporated into any legislation. We pledge to work with you, Mr. Cbairman, and this Committee to enhance the workings of the mortgage lending system. The efforts I described above indicate how serious the banking industry takes the current problems in the mortgage market and they demonstrate how dedicated we are to finding workable solutions.

Let me turn to the principles that I've outlined above.

I. Sound Underwriting Principles Based on the Borrower's Ability to Repay are Needed in Every Mortgage Loan

Any legislation aimed at addressing the recent problems experienced in the mortgage market should focus first and foremost on sound underwriting standards. Mortgage lenders rely on a variety of borrower characteristics when determining whether or not to submit a loan for underwriting approval. However, primary emphasis should be given to the most important characteristic – ***the borrower's ability to repay the loan.*** Mr. Chairman, we agree with you that creditors should be required to make a reasonable determination, at the time a mortgage loan is made, that the borrower does in fact have the capacity to pay back the loan.

The ability to repay standard has consistently served banks well, and the federal banking agencies have taken steps to ensure that banks employ this standard as part of sound underwriting. They first issued guidance on subprime lending in 1999 and expanded it in 2001 to emphasize that lending standards should include well-defined underwriting parameters, such as acceptable loan-to-value and debt-to-income ratios and minimum acceptable credit scores. Mr. Chairman, these are principles your legislation would apply to all originators.

In recent years, innovation in the mortgage industry allowed for the creation of new products, making it possible for previously underserved borrowers to get loans. The banking regulators recognized that the evolving marketplace required additional regulatory direction and they produced additional guidances in 2005, 2006, and 2007. Each of them focuses on underwriting standards rather than mortgage products themselves. Banning products only stymies innovation. Strong underwriting allows banks to offer products to a diverse range of customers while ensuring that those customers get products that meet their particular financial needs and situation.

Thus, it is critical to distinguish between a bad product and bad use of a good product. Reform should not focus on eliminating particular mortgage products but rather on ensuring that all mortgage products abide by the simple, but highly effective, ability-to-pay standard. The legislation introduced presents concepts such as presenting consumers with a "range of mortgage loan products 'appropriate' to the consumer's existing circumstances." Such broad concepts are subjective and will lead to much litigation, likely driving up cost to both lenders and consumers. Imposing a duty of care requirement is reasonable, but it must be based on objective standards centered on the ability to pay.

We must be careful not to stymie innovation, but rather to stop the unfettered experimentation by non-bank originators. Of course, regulatory guidance only applies to insured depository institutions, which leads me to our second principle relating to consistent standards.

II. Consistent Standards are Needed, Particularly to Bring Non-Bank Mortgage Originators Up to the Standards Applied to Bank Originators

Banks have long been subject to the Truth in Lending Act and the Home Owner's Equity Protection Act (HOEPA) amendments thereto, the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, and the Fair Lending Act, among other consumer protection laws. These laws require numerous disclosures relating to mortgage loans generally, and especially so-called high-cost loans, as well as restrictions on fees and other terms for high-cost loans. Additionally, continually updated regulatory guidance is enforced by the banking agencies, including those recently promulgated on nontraditional mortgages and subprime mortgage lending.

Independent mortgage brokers are not subject to the breadth of consumer protection laws and regulations with which banks must comply and, importantly, a regulatory system does not exist to examine them for compliance even with those laws, such as the Real Estate Settlement Procedures Act (RESPA), which do apply to them. In addition, because of the nature of their jobs, independent brokers may not have the same level of interest in the quality of the loan they process. Once the loan closes and the independent broker is paid, he or she has no further financial interest in, or responsibility for, the loan or obligation to the borrower, although most want to preserve their reputation for long-term relationships.

Mr. Chairman, your legislation seeks to address these inconsistencies in part by requiring all mortgage originators to be licensed and registered, and by imposing a net worth or bonding requirement. While we understand the principle here, we are very concerned about the level of regulatory burden that licensing and registration will add to banks, which already meet high ethical, regulatory and examination standards. We are also concerned that without supervision of non-bank originators, registration and licensing will not be effective – and may, in fact, give customers the impression that there is an appropriate level of oversight when there is not. In addition, the bonding requirement for non-bank brokers is insufficient to back the volume of lending undertaken.

We believe that independent mortgage brokers play an important role in the mortgage lending industry. However, it is essential that all brokers be honest, trustworthy, and reliable. We must ensure that consumers receive credit on fair and equitable terms. It is vital that they be served by legitimate lenders with appropriate levels of regulation.

We agree, Mr. Chairman, with your assessment in your *Boston Globe* article:

> Reasonable regulation of mortgages by the bank and credit union regulators allowed the market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis. At every step in the process, from loan origination through the use of exotic unsuitable mortgages to the sale of securities backed by those mortgages, the largely unregulated uninsured firms have created problems, while the regulated and FDIC-insured banks and savings institutions have not. To the extent that the system did work, it is because of prudential regulation and oversight.[1]

It is important to bring other originators up to the same level of scrutiny as already exist in the banking industry.

III. Legislation Should Not Disrupt the Marketplace

With any legislation, the potential for unintended consequences exists, and I want to express some of our concerns. First, legislation should be carefully crafted so as not to disrupt the vibrancy of the prime market. The current problems in the mortgage market have largely been confined to the subprime market and the prime market has been affected to a much lesser extent. Moreover, prime mortgage loans comprise the vast majority of the total mortgage market. In fact, a recent survey by the Mortgage Bankers Association indicates that roughly 77 percent of all mortgages currently outstanding are prime.[2] Efforts to ensure sound underwriting standards must take care not to impose additional

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[1] *Boston Globe*, September 14, 2007.

[2] National Delinquency Survey from the Mortgage Bankers Association, Q2-07. (Data as of June 30, 2007)

paperwork or other costly burdens that would reduce the amount of credit generally, and particularly to the prime mortgage market and where lenders are adequately regulated.

It will be equally important to ensure that a market is maintained for qualified subprime borrowers as well. The development of the subprime market has been of great assistance to many previously underserved populations, and subprime lending is a vital source of credit to many individuals who would not have access to loans without it. Much of the lending that we do in our communities is not to those businesses or individuals with the highest credit scores. Rather, there are many subprime borrowers that are just as deserving of loans and who should not be denied the opportunity to own a home simply because they do not qualify for a prime loan.

Second, while we understand your intention to address the role of securitizers in the mortgage process, Mr. Chairman, care must be taken to avoid disruption of this key channel of mortgage finance. The fact is that the secondary market plays a critical role in allowing broad access to mortgage financing to the widest number of people at the lowest possible interest rates. It is imperative that this market continue to be active and vibrant.

Third, I would be remiss if I did not mention a concern that I have heard from many bankers about the additional paperwork burden that may result from additional legislation. It is no surprise to this Committee that banks are struggling under the weight of increasing levels of regulatory burdens, many of which do not serve the objective of making the nation's banks operate more soundly or to provide meaningful protections to consumers. These burdens have a particularly deleterious effect on community banks like mine. They raise costs and place unnecessary strain upon our ability to serve our customers.

It is critical to recognize, Mr. Chairman, that banks, particularly community banks, are already strained to the breaking point under the weight of thousands of pages of regulation, guidance, and other mandates. In fact, the very future of community banks is threatened by high regulatory costs. As these costs increase, more and more community banks are being driven out of business by government and forced to sell.

It would be unfair to saddle these institutions – which generally had nothing to do with the current problems – with more burdens. Imagine the reaction of a community bank, which never made any of the types of loans that caused the problem, to new regulatory burdens. In fact, many banks tried to warn local consumers against "toxic" types of loans and had to watch as those consumers took on obligations they did not understand and apparently could not resist. Should that bank now have to go through the burden of having individuals in that bank licensed and subject to standards in the same way as freestanding mortgage brokers? Note that many bank employees are likely to have other responsibilities within their organization and make only a limited number of mortgage loans. We hope to work with you to minimize whatever burdens may result from enactment of this legislation.

Fourth, the legislation imposes a new nationwide requirement that existing leases be honored by a creditor in the event of foreclosure. Lenders work hard to minimize the impact on renters in the unfortunate incident of a foreclosure. This can be a complicated process as it involves state and local law. We are concerned about adding a new federal requirement and the impact that such a requirement will have on a creditor's ability to return a foreclosed property to the marketplace. This provision may in fact slow that process leading to further instability for those properties and the neighborhood.

Conclusion

Mr. Chairman, we appreciate the efforts that you and the other members of this committee have undertaken to find long-term solutions to the problems in the mortgage markets. The ABA and ACB – and all our member banks – want to be part of the solution and we stand ready to work with this committee to effect positive change.

National Association of Mortgage Brokers

Prepared Testimony of

Marc Savitt, President-Elect

National Association of Mortgage Brokers

on

"Legislative Proposals on Reforming Mortgage Practices"

Before the

House Financial Services Committee

United States Congress

Wednesday, October 24, 2007

Good morning Chairman Frank, Ranking Member Bachus, and Members of the Committee, I am Marc Savitt, President-Elect of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on "Legislative Proposals on Reforming Mortgage Practices." We appreciate this opportunity to share with you our views on the *Mortgage Reform and Anti-Predatory Lending Act of 2007* ("H.R. 3915").

NAMB is the only national trade association exclusively devoted to representing the mortgage brokerage industry, and as the voice of the mortgage brokers, NAMB speaks on behalf of more than 25,000 members in all 50 states and the District of Columbia. NAMB members are typically small business men and women, who adhere to a strict code of ethics and best lending practices when presenting consumers with an array of mortgage financing options to choose from. Mortgage brokers typically maintain business relationships with various lenders so they can offer a variety of loan products to their customers. Our members play a critical role in helping the American economy and in making the dream of homeownership a reality for American families.

I. ***Introduction***

We take this opportunity to share with the Committee our longstanding view that abusive lending practices can and sometimes do occur throughout the entire mortgage marketplace, which includes originators, funding providers, servicers, affiliated companies, securitizers, and Wall Street investors.

However, addressing the manner in which individual loan officers present different loan programs to consumers and how consumers understand the features of the loan product they ultimately choose is a critical component of any reform effort. For this reason, we support the implementation and enforcement of minimum standards for all mortgage originators; the creation of a national registry to track and remove bad actors from the industry; improved enforcement of prohibitions against deceptive and misleading advertising of mortgage products; reformed mortgage disclosures; and efforts to improve consumer understanding of the mortgage process and products available in the marketplace.

We appreciate the all originator construct of H.R. 3915, but we must urge the Committee to exercise caution when contemplating the transfer of excessive risk to originators, lenders, and securitizers, because undue risk transference will only lead to higher prices and a lack of available credit for deserving consumers.

II. *Title I (Mortgage Origination)*

NAMB shares the Committee's concerns about responsible lending and, in particular, the need to implement uniform minimum standards for mortgage originators, regardless of corporate organization or structure. NAMB supports removing bad actors from the mortgage marketplace while at the same time preserving access to mortgage credit for those consumers who qualify. We applaud the uniform approach taken in H.R. 3915, but we do have some concerns regarding several elements of the bill and its practical implications for consumers and the industry.

1. A Federal Duty of Care for All Mortgage Originators

Since 2002, NAMB has consistently advocated for more stringent standards for all loan originators to protect consumers and curb abusive lending practices in the mortgage industry. We feel strongly that the value of an all originator approach, as in H.R. 3915 and H.R. 3012, lies in the uniformity of treatment of competitors in the mortgage industry. The acts of originating, funding, selling, servicing, and securitizing may all be conducted separately and independently, or may be engaged in collectively under one corporate structure or through affiliated business arrangements. This is why we believe it is important for consumer protections to relate to the function, as opposed to the structure of an entity. Consumers deserve the same level of protection no matter where they choose to obtain a mortgage loan.

Recent events in the mortgage market offer clear examples of why *all* mortgage originators should be subject to uniform minimum standards. The mortgage market of the 21st century has evolved in conjunction with the burgeoning growth of the secondary market for mortgages, but the laws, regulations and oversight of this market have lagged behind to the severe detriment of consumers. Today, any legislative, regulatory, or other governmental effort must account for the fact that the mortgage market is vastly different from the one that existed 20 years ago.

The traditional, "bank-centered," model of mortgage credit involved institutions originating, funding and holding the risk of credit in a mortgage portfolio, which was overseen by in-house risk management and monitoring procedures. Credit and market innovations, such as automated underwriting and lower relative prices, have separated these functions, allowing for greater efficiencies, diversification, spreading of risk, and increased liquidity. Accompanying these innovations were, of course, corporate structure and operational changes that influenced how customers obtained their loans, as well as how these loans were funded, managed and serviced.

Historically a lender was an entity that used its own money to originate and fund transactions. The loan was not sold, but rather kept in portfolio as an asset, and was serviced by the originating lender. This lender maintained a direct relationship with the borrower from the time of origination through funding and collection of the loan. Today, this is no longer the case. It is now common for originator entities and individuals to act in various capacities, whether in a true creditor capacity (lender), a correspondent lender capacity,[1] a table funding capacity,[2] a broker capacity (despite the fact that their state-issued business license may say "mortgage lender"), or some combination thereof.

We do not deny that differences exist between depository and non-depository institutions, both in terms of their business models and how they are regulated, primarily because some of these entities are involved in businesses other than mortgage lending, namely banking. However, when it comes to the origination of mortgage loans, these entities are virtually indistinguishable, particularly in the eyes of consumers, and should be held to the same minimum standards.

The reality of today is that any legislative proposal should take into account how the mortgage market has evolved in relation to the burgeoning growth of the secondary market for mortgages. As was revealed in the recently released Government Accountability Office ("GAO") report on *Recent Default and Foreclosure Trends for Home Mortgages,*[3] the problems facing the mortgage market are not exclusively attributable to one distribution channel and are the result of a combination of factors including: origination, underwriting, servicing, debt collection, the secondary market, securitization, and the bond rating system. We believe this report illuminates the need to address all market competitors, and we again applaud the balanced and even approach taken in the legislative proposals being discussed here today.

2. *Licensing & Registration for All Mortgage Originators*

The growth that has occurred in the mortgage finance industry has led to a corresponding rise in the number of uneducated and unlicensed mortgage originators, and it has become clear that these unlicensed and uneducated bad actors have found homes in all segments of the industry. Over the past seven years, the mortgage market has grown due to low interest rates, investor speculation, rising home values, the creation of new and innovative loan products, the growth of the secondary market for mortgage products, and the increased sophistication of securitizers. Additionally, market demand for more originators lead to a rapid rise in employment, often at the expense of a knowledgeable and responsible workforce. In a rush to hire, standards were loosened by some to achieve or enhance their growth. Without strong standards, this growth went unregulated and unchecked, resulting in a largely under-educated and unscreened originator workforce. Now, we are experiencing a contraction. To ensure we are not doomed to repeat this cycle again, it is critical to establish strong national standards that apply to all originator entities, regardless of size, corporate organization or structure.

When consumers are sitting across the table from a mortgage originator, they generally cannot distinguish one distribution channel from another. From the perspective of the consumer, there is essentially no difference between banks, lenders, and brokers when it comes to originating mortgage loans. Moreover, there is no reason to distinguish one distribution channel from another when each is engaged in essentially the same activity. It is not in the consumers' best interest to draw artificial lines between entities based

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[1] When a lender is engaging in any one of these types of transactions and is offering multiple product lines of other lenders, that lender is acting as a correspondent lender.

[2] A correspondent lender can also engage in a table-funded transaction. Table funding is the origination of a loan by a correspondent lender with a simultaneous transfer or sale of the loan at the time of funding to a lender. In a table-funded transaction, the originating company is a creditor for purposes of TILA and therefore, state and federal agencies treat them as lenders. However, The Department of Housing and Urban Development ("HUD") has determined that table-funded transactions are mortgage broker transactions for purposes of the RESPA, subjecting these transactions to the YSP disclosure requirement. Therefore, the correspondent lender who table funds is essentially both a lender and a broker.

[3] *"Information on Recent Default and Foreclosure Trends for Home Mortgages and Associated Economic and Market Developments,"* United States Government Accountability Office, October 16, 2007.

upon their size, structure, or place in the federal-state regulatory dichotomy. There is absolutely no relationship between the size or structure of a mortgage company and the quality of its loan officers. Regulating only small segments of a larger industry leaves cracks for bad actors to continually slip through, as evidenced by the ease of un-checked movement of loan officers from one employer to another in today's market.

The *Watters v. Wachovia* Supreme Court decision created a bifurcated regulatory landscape in the mortgage industry. Two separate mortgage camps now exist: those operating solely under federal regulation, *versus* those in the 'non-bank camp,' which are subject to both federal and state oversight. We have already begun to see some of the effects of the *Watters* decision, as non-bank mortgage operations looking for shelter from this layered oversight are being solicited by national banks to use their federal charter to bypass all state licensing and consumer protection regulations. Moreover, as many non-bank lenders continue to downsize and shut-down mortgage operations, countless loan officers are being terminated, and we are now seeing these individuals receive job offers from federally-chartered institutions that are marketing themselves by saying how easy it is for their loan officers to make loans and avoid state licensing requirements designed to protect consumers. The *Watters* decision has created an imbalance in the mortgage industry oversight scheme that regulates a market vastly different from the one that existed 20 years ago, at the advent of the secondary mortgage market.

More must be done to increase professional standards for all mortgage originators. Since 2002, NAMB has advocated strongly that a minimum level of education and mandatory testing for all loan officers, regardless of employment, must be a central component of any effective solution to the problem of abusive lending. Education and testing of every mortgage originator helps to ensure that consumers will receive accurate and consistent product information that will allow them to make an informed decision about different loan financing options available in the market. To ensure all mortgage originators remain knowledgeable and competent to address customer concerns, NAMB also supports mandatory continuing education and professional ethics training. Further, NAMB believes that all mortgage originators should be subject to a federal criminal background check to prevent bad actors from entering or remaining in the industry.

The application of these minimum professional standards to *all* originators will create a mortgage market where consumers are free to shop and compare mortgage products and pricing across distribution channels without fear or confusion. Although it continues to be suggested by some that requiring minimum standards for all loan originators is unnecessary, we strongly disagree. The creation and implementation of a national minimum standard for every mortgage originator is neither burdensome nor duplicative of existing oversight and regulation. Such a standard, when implemented across every distribution channel, raises the bar for anyone currently failing to meet it, and imposes no greater restrictions on any state or entity whose requirements already surpass it.

For these reasons, we support the all originator concept contained H.R. 3915. It is a balanced and even approach that includes every mortgage originator who will sit down with a consumer and help them through the application and origination process, leaving no refuge within the industry for bad actors.

3. *Creation of a National Registry*

NAMB has long supported the establishment of a national registry, provided: (1) it is governed by a federal agency such as the FTC, the Federal Reserve Board, or HUD; (2) the federal government requires every individual mortgage originator, including loan officers working for federal and state-chartered banks and lenders, credit unions, and mortgage brokers to register; (3) every individual pays a fee to be in the registry; and (4) the fee is used to cover operational costs for the registry, create funds earmarked for additional enforcement of mortgage laws, and assist ongoing consumer financial literacy programs.

Today, a single national system to collect, store and track information on all mortgage originators, whether state or federally regulated, does not currently exist. The creation and establishment of a national registry would help to identify and track bad actors operating within the ranks of the mortgage industry. We believe individuals who choose to work in the mortgage industry should be held accountable for their actions. If any mortgage originator is found guilty of improper conduct, he or she should be kicked out of the industry permanently.

A national registry that includes all originators will aid significantly in the effort to fight mortgage fraud uniformly across all segments of the industry, and will stop bad actors from remaining in or entering the industry. Additionally, a national registry of all mortgage originators could also serve as a clearinghouse for complaints against mortgage originators, regardless of whether they are state or federally-regulated, thus aiding consumers who often do not know who to call or where to turn when experiencing a problem with their mortgage originator.

Without universal inclusion in the registry however, bad actors will remain free to move, unchecked, from one entity to another and one community to another without any interference, and consumers will continue to bear the burden of trying to identify the appropriate regulator to contact when there is a problem. A national registry will afford *all* current and prospective homebuyers protection from predatory lenders, who should be given nowhere to go but out of the industry entirely. We support the inclusive language in H.R. 3915, and we strongly urge the Committee to ensure that no market participant be excluded from the registry as the bill is debated and moved through the legislative process.

4. *Additional Specific Disclosures.*

NAMB believes that consumers who understand the mortgage process are better able to make informed decisions about loan products, features, and pricing options. We also believe that improved and mandatory disclosures will help expose the activities of certain unscrupulous mortgage originators who try to shield themselves from detection by keeping consumers uninformed. NAMB appreciates the inclusion of language in the bill that calls for improved disclosures to consumers early on in the mortgage process and requires mortgage originators to disclose their relationship with the consumer.

The proliferation of affiliated business arrangements and the blurring of once clear lines of delineation between distribution channels have made it more difficult than ever for consumers to understand the role that their mortgage originator will play in the loan transaction. NAMB believes consumers will benefit from a clear, upfront, and uniform disclosure of the role of the mortgage originator. To enhance consumers' ability to comparison shop, a full and fair disclosure of the mortgage originator's role should be required to be given to borrowers at the onset of the mortgage shopping experience. We cannot emphasize enough the importance of requiring uniform disclosures to be given to consumers in all mortgage transactions. Anything less will confuse consumers and risk causing them to select a higher cost mortgage.

The Federal Trade Commission's February 2004 Staff Report – "The Effect of Mortgage Broker Compensation Disclosure on Consumers and Competition: A Controlled Experiment" – illustrates how the lack of uniform disclosures can actually result in increased cost for consumers. The staff report on HUD's 2002 proposed RESPA rule, which required certain disclosures by mortgage brokers only, stated that when such disclosures were tested on consumers, they were likely to "confuse consumers, cause a significant proportion to choose loans that are more expensive than the available alternatives, and create substantial consumer bias against broker loans, even when broker loans cost the same or less than direct lender loans."

Since 1998, NAMB has urged the U.S. Department of Housing and Urban Development ("HUD") to adopt a role of the mortgage originator disclosure as part of the required disclosures under the Real Estate Settlement Procedures Act ("RESPA"); however, to date, HUD has failed to implement any such standard. Some states have adopted this as a requirement, but this is still not enough.

We strongly believe that a simple, straight-forward disclosure of the mortgage originator's role, will eliminate any confusion on the part of consumers and strengthen consumers' bargaining position when shopping for a mortgage.

A direct analogy may be drawn to the real estate brokerage industry, which is also largely state-regulated. Not unlike mortgage originators, real estate brokers and agents deal with different parties to a transaction (buyers and sellers) in a variety of different capacities. Real estate brokers and agents may enter into an agency relationship with either a buyer or a seller; or they may function in a limited agency capacity for both the buyer and the seller. Alternatively, they may elect not to enter into any agency relationship at all and act exclusively as an intermediary. We believe that mortgage originators can operate under a similar model, where they choose, along with their customers, to enter into an agency relationship with either the lender or the borrower; serve as the limited agent for both the lender and the borrower; or, act as an intermediary only in the mortgage transaction.

Because of the complex and sometimes uncertain nature of the relationship between originators and borrowers, we believe consumers will benefit from a clear, concise, and mandatory disclosure of that relationship early in the mortgage shopping stage. In addition to choosing the loan product and pricing options that they prefer, consumers should be given the opportunity to make an informed choice of whether to shop around or work with a mortgage originator who is willing and able to act as their agent in the transaction. Requiring all originators to clearly and accurately inform consumers of their role in the transaction will enhance consumers' ability, and perhaps their desire, to comparison shop and find a loan product and originator they are comfortable with.

5. *Anti-Steering*

Title I includes an anti-steering provision, which applies to all mortgage originators. This provision specifically prohibits anyone from paying and any mortgage originator from receiving incentive compensation that is based on or varies with the terms of a loan (including yield spread premium ("YSP")). While we support disconnecting compensation from the origination of specific loan products or features of those products in an effort to address steering, we have grave concerns over the practical, and perhaps unintended, consequences of this provision on the industry as a whole, but particularly the small business broker channel and the consumers that it serves.

For example, a stated objective of several fair lending laws is to ensure affordable credit is available to low and moderate income borrowers and that lending occurs in outlying communities that are traditionally underserved by large lenders and banks. The government clearly wants to encourage lending to low and moderate income individuals and underserved communities, as evidenced through laws such as the Community Reinvestment Act. This paradox in housing objectives must be addressed. We should be careful to avoid the unintended consequence of negatively impacting lending to deserving low and moderate income borrowers or underserved communities. This is especially necessary given the current market climate where lending to these market segments is already suffering due to the credit crunch.

We urge the Committee to amend and clarify the anti-steering language included in Title I to make clear that mortgage originators are not prohibited from earning indirect compensation. The financing of points, fees, and indirect originator compensation, regardless of what it is called, helps consumers by lowering the cash needed to close a mortgage transaction while compensating the originator for his or her services.

The use of indirect compensation has proven to be a vital tool for first-time homebuyers, and critically important in helping countless consumers purchase a home or manage their finances.

Today, most consumers shop for a loan asking for a loan rate at zero points. In this scenario, the consumer is asking to finance into the loan rate the 'origination fee', a term of art understood in the market to refer to points paid upfront to originate the loan. When the origination fee is financed through the interest rate it becomes what is known in the market as indirect compensation, which is paid by the wholesaler, retailer or investor/secondary market to the mortgage originator (*i.e.*, yield spread premium, service release premium, or gain on sale). This zero point loan is the "typical loan" that represents somewhere between 85 and 90% of the market because it has clear benefits to the consumer: (1) it lowers the amount of cash needed to bring to closing; and (2) may actually decrease the total origination fee paid on the loan if a borrower remains in the home only 5 to 7 years, or refinances within that time period.

Indirect compensation is how mortgage originators get paid for their loan origination services when a consumer does not want to pay any points, or is able to pay only some of the fees upfront. Indirect compensation is also a legitimate and legal way for borrowers to forgo paying their closing costs upfront and instead, finance those costs through the interest rate. When the consumer chooses not to pay any origination fees or closing costs upfront, they are receiving what is known as a no-cost and/or no-fee loan. Again, zero point and no-cost/no-fee loans are offered widely by ***both*** broker and retail lender channels and made available because of the indirect compensation structure that currently exists.

Thus, indirect compensation is beneficial for many consumers who are ready to own a home but have to overcome the hurdle of significant closing costs, or for customers that choose to realize the savings of keeping their cash and financing their costs through their loan rate. Choosing to finance closing and origination costs through the rate allows borrowers to purchase and start building wealth through their home without requiring significant outlay of cash at the onset of the loan.

As stated above, every mortgage originator that does not keep loans in portfolio earns this indirect compensation – it's just called something different for each competing originator entity. YSP is a payment by a wholesaler to a retailer in a broker transaction in return for operating costs absorbed, services performed, closing costs financed, if applicable, and/or the value of the loan. Service release premium ("SRP"), or gain on sale, is what a lender, banker, or wholesaler receives as payment from an investor – again, for costs absorbed, services performed, the financing of any closing costs, and/or the value of the loan.

Indirect mortgage originator compensation has existed from the time loan origination services expanded out of the S&Ls and the banking industry moved away from keeping loans in portfolio. YSP came to the forefront in 1992 because of a HUD ruling under the Real Estate Settlement Procedures Act ("RESPA"). This ruling exclusively required mortgage broker transactions (those that do not fund and close loans in their name or those that table-fund) to disclose YSP on the good faith estimate ("GFE") and again on the HUD-1. As a result, the only real difference that exists in today's market between SRP, gain on sale and YSP is that YSP is the only form of indirect compensation that is currently required to be disclosed, both on the GFE and again at closing

This artificial line, drawn by HUD in 1992 and based on 'industry jargon' and entity structure, rather than function, has shifted intense focus on YSP, while shielding SRP and gain on sale from similar scrutiny. This is despite the fact that prior to the 1992 HUD ruling all three were considered one in the same – namely, indirect compensation paid to the originator by either the lender or the investor/secondary market in return for services performed and the value of the loan.

Any provision that intends, or is interpreted to intend, to ban indirect compensation will have a detrimental impact on the marketplace, eliminating cost-effective loan options for thousands of consumers and increasing costs significantly. In addition, any provision that intends, or is interpreted to intend, to ban only the broker's compensation will destroy small business mortgage originators in this country, resulting in fewer market participants, less competition, and ultimately higher prices for consumers. With small business mortgage originators unable to earn indirect compensation, they will be prevented from assisting any consumer who chooses or is unable to come to the closing table with anything less than 20% down payment and cash for full closing costs and origination fees. Consumers looking for a zero point loan, or a no-cost/no-fee loan, will be forced to turn to the banks, placing those entities in a market position to charge the consumer even more for origination services. Furthermore, differential treatment of YSP will simply create a market distortion, pushing brokers to get a wholesale lines of credit, thereby enabling mortgage brokers to earn a SRP rather than YSP, similar to their industry counterparts.

We do not believe it is the Committee's intent to legislatively pick winners or losers in a fiercely competitive marketplace or further disadvantage small business in the mortgage industry. We also do not believe it is the Committee's intent to disadvantage the very consumers who are most in need of greater access to affordable credit. NAMB looks forward to continuing to work closely with the Committee on this issue, and we hope the Committee will consider revising the language in Title in recognition of the important role that indirect compensation plays in helping consumers become homeowners.

6. *Requiring Mortgage Originators who Advertise the "Best" Deal to Actually Deliver the Best Deal to their Customers*

NAMB believes in strengthening prohibitions against the deceptive marketing and advertising of mortgage products. Last month, the Federal Trade Commission ("FTC") warned over 200 mortgage lenders, brokers, and media outlets that some ads appearing in print and online may be in violation of federal law. The FTC noted that "many mortgage advertisers are making potentially deceptive claims about incredibly low rates and payments, without telling consumers the whole story – for example, that these low rates and payments apply for a short period only and can go up substantially after the loan's introductory period. Homeownership is the American dream, but it can become a nightmare for consumers who don't have the information they need to understand the terms of their mortgage."[4]

We support the efforts being undertaken by the FTC and we urge all state and federal regulators to strengthen and increase enforcement actions against any party involved in the deceptive advertising or marketing of mortgage loan products or services to consumers.

While we support measures designed to ensure truthful and clear advertising to consumers, we must emphasize that what is "best" depends upon three inter-related concepts: product availability, price, and service. Focusing solely on a price of a product may not yield the "best" result for a consumer. Only the consumer can determine the "best" combination of factors that fit their needs. The consumer is the decision maker, *not the mortgage originator.*

Therefore, it is imperative that provisions in this bill that address the interests of the consumer be crafted in a manner that ensures that the integrity of the consumer decision-making process remains intact. Consumers currently enjoy the freedom and responsibility to choose their own mortgage products, take advantage of the competitive marketplace, shop, compare, ask questions, and expect answers. Consumers are and must remain the ultimate decision makers regarding the product, price, and services purchased in

[4] "*FTC Warns Mortgage Advertisers and Media That Ads May Be Deceptive,*" FTC Press Release, September 11, 2007, quoting Lydia Parnes, Director, FTC Bureau of Protection.

conjunction with mortgage financing. Selecting a mortgage is a very personal choice, and *only* the consumer can determine whether a particular loan product is "suitable" for his or her financial needs and goals, or if it might be in his or her "best" interest to continue shopping.

7. Surety Bond or Net Worth Requirement

We are supportive of uniform national standards for all mortgage originators that will increase accountability and professionalism in our industry, however, we believe requiring an unreasonably large surety bond or unrealistically high net worth will severely disadvantage small businesses, without providing any real benefit to consumers. We support the concept of a required surety bond for all mortgage originators, and appreciate that the language in H.R. 3915 would not require originators to satisfy both a surety bond and net worth requirement. Recognizing the clear burden that an unreasonably large bond or net worth requirement would have on small business originators, we believe that a $50,000 bond is adequate, provided that number is scaled up to $100,000 for larger volume originators. A $50,000 bond requirement will provide sufficient protection for consumers and the market, while not severely disadvantaging small businesses.

Although it has been suggested by some that a minimum net worth and capital requirement should be imposed on all mortgage market participants, regardless of business activities or size, as a measure of stability and accountability in the market, we have witnessed first-hand that such requirements do little to protect consumers or the market.

Net worth is illusory. Many (large) lending companies that were once viewed as financially solid are bankrupt and gone, proving that capital and net worth requirements are ineffective indicators of a mortgage originator's ability to service or make the consumer whole. A financial statement provides no assurance at all that an originator will *maintain* their net worth; it simply provides a snapshot and can easily disappear. Imposing capital and net worth requirements does not enhance lending standards, but rather merely promotes market shares among competing channels. Capital and net worth requirements succeed in erecting barriers to small businesses entering the market, place an unfair and undue burden on them, and inhibit competition, leaving consumers with fewer choices and increased costs, while failing to offer any real protection to consumers now or in the future.

In short, size and wealth do not automatically equate to honesty and competence. This fact must guide any legislative or regulatory action.

III. *Title II (Minimum Standards for All Mortgages)*

NAMB strongly supports the all originator construct of H.R. 3915, and we believe it is important for underwriters to make a reasonable assessment of a borrower's ability to repay a mortgage loan at the time such a loan is consummated. We also support the additional standards and requirements included in Title II, which prohibit certain prepayment penalties, single-premium credit insurance, and mandatory arbitration. However, we believe the regulators must be cautious when crafting corresponding rules, so that they do not unintentionally expose consumers to the risk of being arbitrarily rejected for credit when it is needed.

Although we are supportive of the ability to repay and net tangible benefit requirement included in H.R. 3915, objective parameters are critical because we do not feel that consumers will ultimately be served by a standard that allows for a wide range of subjectivity. We fear a lack of objective parameters could have numerous unintended consequences, leading to many consumers being shut out of the mortgage market without justification. The market has already adjusted, and we are concerned that some of the language in

Title II of H.R. 3915 risks harming consumers and possibly exacerbating the current problems in the real estate market.

IV. Title III (High-Cost Mortgages)

While NAMB is supportive of the all originator approach in H.R. 3915, we are extremely concerned that specific provisions in Title III will only result in further harm to many consumers who are currently in the most need of credit. We urge the Committee to consider deleting Title III in its entirety, at least until the market has an opportunity to stabilize.

1. Points and Fees Threshold

Section 301 would reduce the "points and fees" trigger for "high-cost loans" under the Home Ownership and Equity Protection Act ("HOEPA") from 8% to 5%, and include all costs and fees charged to the borrower. NAMB opposes this provision of Title III of H.R. 3915 and believes it is imperative that any legislation addressing the "points and fees" threshold for HOEPA directly and expressly exclude indirect mortgage originator compensation, as well as any seller concessions, seller-paid points, and government loan program fees (*i.e.*, FHA / VA) from the calculation.

There are two principal reasons for our stated position. First, we are concerned that lowering the threshold will capture a large number of loans and borrowers that are not in need of the extra protections that HOEPA provides. Reducing the trigger to 5% and including all costs and fees in that calculation will shrink the availability of credit for borrowers who need it. We are concerned that that many lenders will decide not to make loans that cross this new HOEPA threshold, which will put many consumers in a particularly perilous position as interest rates rise. As a result, the supply of smaller second mortgages will dry up and consumers will be forced to choose between high-cost credit card debt and refinancing out of favorable first mortgages to meet their immediate needs.

Second, under HOEPA currently, a loan is covered if one of two thresholds are met: (1) the Annual Percentage Rate ("APR") exceeds Treasury securities by 8%, and 10% for second mortgages; or (2) the total "points and fees" paid by the consumer exceed the greater of 8% of the loan amount or a set dollar amount ($547 for 2007), adjusted annually for inflation. Indirect mortgage originator compensation is *already captured* in the APR threshold. Including this compensation in the "points and fees" trigger, as proposed in H.R. 3915, is unnecessary and duplicative. We strongly urge the Committee to revise Title III and raising the "points and fees" threshold.

2. Prohibition Against Financing Points and Fees

Section 302 of H.R. 3915 prohibits the financing of points or fees on high-cost loans covered by HOEPA. We urge the Committee to reconsider this prohibition, and either remove it or revise Title III so that trigger is raised significantly. In practice most points and fees on non-prime loans are financed, because most non-prime borrowers do not have ready access to the cash needed to pay such points and fees or they do not want to tap other illiquid assets to do so. This restriction, if enacted, would effectively eliminate from the market all borrowers who can't qualify for a non-high-cost mortgage, and who are unable to afford the significant upfront costs associated with obtaining a mortgage loan.

We believe it is important to react to a real risk, not merely a perceived risk. Currently, the true magnitude of the problem in the mortgage market remains unclear. There are conflicting reports and estimates that vary significantly in their assessment of the real extent of the current and projected market turmoil. The recently released GAO report[5] predicted that roughly 1.1 million loans originated from 2004-2006 would foreclose over a six to seven year period, compared with the estimated 2.2 million foreclosures that the Center for Responsible Lending ("CRL") has forecasted. These dramatically contrasting figures serve to further confuse the issue and reinforce the importance of not over-reacting to a perceived or exaggerated problem, which could result in greater harm than good for consumers. Tempered responses and proposals are critical in a market that is already prone to over-reaction.

3. Pre-Loan Counseling Requirement

NAMB opposes the inclusion of provisions intended to expand and require counseling programs for borrowers, prior to purchasing a high-cost loan. Counseling requirements unnecessarily slow down the loan process for consumers and make "emergency" loans virtually unattainable. Moreover, the experiences in Ohio have clearly demonstrated that mandatory counseling harms both consumers and the neighborhoods in which they live.

V. Escrow, Appraisal and Mortgage Servicing

Although not specifically addressed in H.R. 3915, we want to take this opportunity to commend Reps. Kanjorski (D-PA), Wilson (D-OH), Hodes (D-NH), and Chairman Frank (D-MA) for proposing the *Escrow, Appraisal, and Mortgage Servicing Improvements Act* ("HR 3837"). NAMB believes that efforts to require escrows for certain mortgage loans, to improve mortgage servicing, promote sustainable homeownership opportunities, and improve the appraisal process are laudable, and we support legislation that furthers these ends.

VI. Conclusion

NAMB appreciates this opportunity to share its views on the *Mortgage Reform and Anti-Predatory Lending Act of 2007.* Everyday our members live and work in their communities alongside consumers; and from this we know that consumers want to be able to get a loan they can afford and keep. We strongly believe that consumers deserve the same level of protection no matter where or with whom they choose to get their mortgage loan from, and we applaud the broad and even approach taken in crafting this legislation.

As was revealed in the aforementioned GAO report[6], consumers have been negatively affected by a myriad of market forces and participants, and the root of the problems in the mortgage market today cannot be traced to any single source. Consequently, the solutions to today's problems must encompass and be embraced by all market participants.

While we are supportive of many of the overall concepts embodied in H.R. 3915, particularly the all originator construct, we urge the Committee to exercise caution when contemplating legislative action that could significantly reduce the availability of credit and unintentionally harm many of the consumers who need help the most. NAMB looks forward to continuing to work with this Committee on its efforts to protect consumers from abusive lending practices, while maintaining the availability of affordable credit and preserving opportunities for small businesses throughout the nation.

Thank you for the opportunity to appear before this Committee and discuss this very important piece of legislation. I am happy to answer any questions that you may have.

[5] *"Information on Recent Default and Foreclosure Trends for Home Mortgages and Associated Economic and Market Developments,"* United States Government Accountability Office, October 16, 2007.
[6] *Id.*

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STATEMENT OF MR. HILARY O. SHELTON
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NATIONAL ASSOCIATION FOR THE
ADVANCEMENT OF COLORED PEOPLE
ON H.R. 3915, THE *MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2007*
BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

October 24, 2007

Thank you, Chairman Frank and members of this committee for the opportunity to testify before you today on the problems of predatory mortgage lending and on your new legislation, H.R. 3915 the *Mortgage Reform and Anti-Predatory Lending Act of 2007*, which is intended to help bring an end to this heinous practice. My name is Hilary Shelton and I am the Director of the NAACP Washington Bureau, the federal and public policy advocacy arm of our Nation's oldest, largest and most widely known grassroots civil rights organization.

Let me begin by thanking you, Mr. Chairman, as well as your colleagues Congressmen Brad Miller and Mel Watt and others, as well as the entire membership of this committee and your staff for all that you have done to aggressively address the problem of predatory lending. Chairman Frank, Congressman Miller, Congressman Watt, you have all consistently been Congressional champions of the civil rights movement and with this legislation you continue to show your concern and commitment to the rights and protection of all Americans.

Predatory mortgage lending, as anyone who reads the newspapers or watches television can tell you, is having a tremendous negative effect on our communities, our nation and our national economy. In addition to being concerned for the well-being of our great Nation, however, the NAACP is especially concerned about and offended by predatory mortgage lending because of its disparate impact on communities of color.

Predatory lending is unequivocally a major civil rights issue of our time. As study after study has conclusively shown, predatory lenders consistently target African Americans, Latinos, Asians and Pacific Islanders, Native Americans the elderly and women at such a disproportionately high rate that the effect is devastating to not only individuals and families, but whole communities as well. Predatory lending stymies families' attempts at wealth building, ruins people's lives and, given the disproportionate number of minority homeowners who are targeted by predatory lenders, decimates whole communities of color.

According to a recent study by the Furman Center in New York, between 2002 and 2006, the percentage of subprime loans to African American borrowers rose from 13.4% in 2002 to 47.1% in 2005[1]. Furthermore, study after study has shown that African Americans and other Americans of color are targeted by predatory lenders and steered into predatory loans at a disproportionate rate.

These numbers become especially important as subprime mortgage loans become foreclosures. Over the next two years, an estimated $600 billion in subprime mortgages will reset from the two- or three-year teaser rates and many borrowers, including an overrepresentation of African Americans and Latinos, will face a significant increase in their monthly payments[2].

The impact this will have on whole neighborhoods and communities predominantly populated by African Americans, Latinos and other racial and ethnic minority Americans will be nothing short of devastating. A report issued last year by the Center for Responsible Lending estimated that 1 out of every 5 mortgages that originated during the last two years will end in foreclosure[3].

To date, the federal government has been largely inattentive to the problems surrounding predatory lending, and in fact some of the rules and proposals we have seen in the last few years appear to go backward and take away some of the few protections we have gotten at the state level.

This flies in the face of the NAACP's belief that the primary responsibility of the government is to protect its citizens, all of its citizens, not to exploit them or allow them to be exploited them for the financial gain of a few. As our democratically elected representatives, the NAACP has consistently called on Congress to enact aggressive and effective federal laws to curb predatory lending, and to soundly reject attempts at addressing predatory lending that will not resolve the underlying problems and will, in fact, roll back the few protections that a few states have put into place.

That is why the legislation we are discussing today, H.R. 3915, is so important. This legislation aggressively addresses steering, in which borrowers are put into loans that have higher interest rates or involve fees and penalties above what their credit rating warrants. Studies have shown that even higher income African

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[1] Furman Center of calculations of 2006 HMDA data
[2] Jonathan R. Liang, *Coming Home to Roost*, BARRONS (New York, NY), February 13, 2006
[3] Center for Responsible Lending. December, 2006. "*Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners*" Ellen Schloemer, Wei Li, Keith Ernst and Kathleen Keest.

Americans pay more for loans than lower income whites. An example of steering would be the woman who called the NAACP National Headquarters last month to report that she had been convinced to take out a $30,000 home equity loan, and that $26,000 of that loan went to pay points and fees.

In addition to steering, H.R. 3915 aggressively addresses and effectively eliminates yield spread premiums, an incentive for mortgage brokers to steer people into more expensive loans. Yield Spread Premiums are included in 85 – 90% of all subprime loans[4] and provide brokers a strong incentive to charge borrowers a higher interest rate when they could qualify for a less expensive loan.

Another issue that has proven to be a real problem in communities of color and among African American borrowers specifically is prepayment penalties. According to the Center for Responsible Lending, 70% of subprime mortgages feature prepayment penalties. For a family with a $150,000 mortgage at an interest rate of 10%, a typical prepayment penalty imposes a fee of $6,000 for an early payoff (which includes refinancing). This amount is more than the entire net worth of the median African American family at this early stage.

It is because of these problems that we applaud your efforts to aggressively stop some of the more damaging predatory mortgage lending practices through the legislation you recently introduced. H.R. 3915 outlaws steering, yield spread premiums and effectively stops the problems associated with prepayment penalties in the subprime market. The NAACP cannot thank the sponsors and co-sponsors of this historic legislation enough for their aggressive positions on these and other troubling practices that are too often being applied in a discriminatory manner so the result is a disparate decimation of communities of color. We applaud your efforts and pledge to continue to work with you to ensure that these tough yet necessary steps are enacted.

Unfortunately, as the NAACP knows all too well, we must have tough enforcement provisions to ensure that these new laws are adhered to. We cannot allow skirting the law to be seen as merely a cost of doing business. We must make the penalties stiff and we must show industry, as well as the American public, that we mean business.

Let me also take a minute to address an issue that I am sure is on the minds of many involved in this debate. The NAACP strongly believes that there must be a strong federal standard to address predatory lending. We believe that states must abide by those standards. Yet we also believe that states must retain the flexibility to address local or regional issues, and that states can and should be able to address new abusive products that may arise if and when the current problems are addressed.

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[4] Center for Responsible Lending, June 18, 2004, "Yield Spread Premiums: A Powerful Incentive for Equity Theft"

The NAACP believes that any federal policies that are enacted should be treated as a minimum standard, and that states should be able to enact even tougher laws tailored to address their own unique brand of predatory lending.

Thank you again, Chairman Frank, for your efforts; we look forward to continuing to work with you and the rest of the committee to effectively and aggressively put an end to predatory lending.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony of John Taylor

President and CEO, National Community Reinvestment Coalition

Before the House Financial Services Committee

Testimony also on behalf of National Consumer Law Center Rainbow-PUSH

October 24, 2007

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Introduction

Good afternoon, Chairman Frank and Ranking Minority Member Bachus. My name is John Taylor and I am the President and CEO of the National Community Reinvestment Coalition (NCRC). I am honored to be testifying on behalf of the 600 community nonprofit member organizations of NCRC that are dedicated to increasing access to credit and capital for minority and working class communities.[1]

I am also honored to be testifying on behalf of the low income clients of the National Consumer Law Center, Inc.("NCLC") and Rainbow-PUSH. Both Rainbow-PUSH[2] and NCLC[3] have been in the forefront of struggle for consumer protection and civil rights for decades.

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[1] The **National Community Reinvestment Coalition** is an association of more than 600 community-based institutions that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations and social service providers from across the nation. Their work serves primarily low- and moderate-income people and minorities. NCRC pursues its work through a variety of partnerships and programs. Our National Homeownership Sustainability Fund leverages the expertise of a national network of mortgage finance advisors. They work with servicers and lenders, on behalf of homeowners, to keep working families from losing their homes to foreclosure. NCRC's National Training Academy provides training and technical assistance on topics such as understanding how to use CRA, fair housing and foreclosure prevention. Our Economic Justice Campaign sites pilot innovative community partnerships to enhance the delivery of financial, technical, and social services to individual consumers, homeowners, and small business. NCRC's work is enhanced by two financial services advisory councils consisting of the nation's largest banks and mortgage finance companies. Quarterly roundtables examine issues involving responsible financial services-related policies, regulations, and legislation, as well as innovative products, services and best practices.

[2] The **Rainbow PUSH Coalition** is a progressive organization dedicated to protecting, defending and expanding civil rights, to improve economic and educational opportunity for all. The organization is headquartered at 930 E. 50th St. in Chicago. For more information about the Rainbow PUSH Coalition, please visit the organization's website, www.rainbowpush.org,

[3] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, (5th ed. 2003) and Cost of Credit: Regulation, Preemption, and Industry Abuses (3d ed. 2005) and Repossessions(6th ed. 2005) and Foreclosures (1st ed. 2005), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all the federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws.

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Over the last several months, NCRC has testified a number of times, warning that the nation stood on the edge of a mortgage tsunami. When we testified in the spring, we heard the regulatory agencies tell us that the "contagion" would not spread beyond the subprime market. As spring turned into summer, it was clear that the "contagion" had spread broadly throughout the housing market. The industry has flooded the market with exotic mortgage lending such as payment-only Adjustable Rate Mortgages (ARMs), and "hybrid" 2/28 and 3/27 ARMs. These exotic and/or high-cost mortgages overwhelm borrowers when interest rates shoot up after an introductory time period. The sum total of the problematic lending is that up to 2 million mortgages may end up in foreclosure this year and in 2008, costing about $300 billion dollars. Meanwhile, the bailout of Wall Street has started - the Treasury Secretary met with large banks and convinced them to create a $80 billion fund that will buy mortgage backed-securities in the hopes of stabilizing the housing market.

Yet, while the bailout of large financial firms has commenced, who will look out for the millions of families that will lose their homes and their only or primary source of wealth? Mr. Chairman, your bill is a sign of determined leadership to ensure that Americans will be protected against predatory lending. Your bill is comprehensive and your bill makes difficult choices, but in a few critical places, these choices need to be reversed. As we applaud your leadership, we also hope that you will strengthen certain key elements of your bill to prevent any institution from profiting from investments in unscrupulous mortgage lending practices.

Our challenge is to sustain safe and sound credit in communities. We need to eradicate the abusive lending that drains wealth. At the same time, we need to bolster safe and sound lending that builds wealth by creating affordable and sustainable homeownership for hard-working families. Your anti-predatory bill contains key elements that will curb abusive lending, so long as you ensure that it is fully enforceable against all players in the marketplace. While a strong anti-predatory bill will ensure that lending protects equity, enacting the CRA Modernization Bill of 2007 will promote safe and sound lending by applying CRA to a broad array of non-bank financial institutions. We need to apply CRA to mainstream credit unions, independent mortgage companies, insurance companies and securities firms. NCRC's Chief Operating Officer, James Carr, is testifying today before the Subcommittee on Domestic Policy of the Committee on Oversight and Government Reform, asserting that CRA as applied to banks needs to be strengthened and that CRA needs to be applied to non-bank financial institutions.

Research demonstrates that anti-predatory lending legislation reduces abusive lending while CRA increases safe and sound lending. Professor Michael Stegman and his colleagues at the University of North Carolina concluded that while the North Carolina anti-predatory law did not restrict overall access to credit, it did decrease loans with abusive features such as loans with prepayment penalties beyond three years.[4] In addition, a study by Bostic, Engel, et al. concluded that state anti-predatory laws do not reduce overall credit flows. In fact, broader coverage (more high-cost loans covered), stronger enforcement, more liberal private rights of action, and stronger assignee liability are associated with higher levels of subprime originations. The authors hypothesize that consumers feel more confident receiving subprime loans in states with broader coverage.[5] The beneficial impacts of anti-predatory law are coupled with CRA; Federal Reserve economists and Harvard University document that CRA has increased lending to minority and low- and moderate-income borrowers and communities.[6]

NCRC, NCLC, Rainbow-PUSH, and NCRC's 600 member organizations look forward to working with you to enact a strong anti-predatory lending bill and a CRA Modernization bill to stomp out abusive lending and to sustain access to credit for underserved communities during these precarious times of the mortgage meltdown.

Summary of Recommendations

Your bill has the earmarks of landmark legislation designed to address the mortgage crisis this country is facing. We applaud your leadership and urge Congress to expeditiously pass a comprehensive anti-predatory bill.

Our testimony responds to the major provisions of each Title of the The Mortgage Reform and Anti-Predatory Lending Act of 2007 and also responds to the Escrow, Appraisal, and Mortgage Servicing Improvements Act of 2007. We have three major recommendations that include:

No Preemption of State Law: We are extremely pleased that you have resisted the tremendous efforts to convince you to preempt state law with this bill. The dual goals of a federal bill addressing abusive mortgages should be, first – to change the dynamics in the mortgage marketplace and create incentives for sustainable home lending, and second – to improve and expand the consumer protections for homeowners.

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[4] Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, *The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment*, the Center for Community Capitalism, University of North Carolina at Chapel Hill, June 25, 2003.

[5] Raphael W. Bostic, Kathleen C. Engel, Patricia A. McCoy, Anthony Pennington-Cross, Susan M. Wachter, *State and Local Anti-Predatory Laws: The Effect of Legal Enforcement Mechanisms*, August 7, 2007, via http://ssrn.com/abstract=1005423.

[6] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.

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Currently state laws are unable to change the incentives in the mortgage marketplace on a national level. However, state laws are still extremely useful and effective – in many states – in providing relief to homeowners. State statutory and common law claims have been very effective tools to obtain redress for individual homeowners and protecting them from foreclosure. Preservation of these state law protections is an absolutely essential factor in our support of any federal legislation.

The lending industry has thrived in a regime in which HOEPA has served as a floor while allowing for stronger state anti-predatory law that is consistent with HOEPA. It is critical to preserve this regime. Since lending markets differ across states, state governments need the flexibility to respond to their changing and unique situations.

Assignee Liability: The bill needs one significant area of improvement however: all of those who make or fund or service predatory mortgages must be fully accountable for the abusive loans. Without that full accountability, most of the other excellent provisions of your bill will not effectuate the change you intend – and which is so vital to America's homeowners – on the mortgage market.

All players involved in the mortgage loan must be part of the solution – just as they are now part of the problem. The industry and the secondary market all argue strenuously against assignee liability of any sort, saying that credit will dry up if the investors have to assume the costs for predatory loans. Yet the research and the evidence, elaborated on below, suggests that assignee liability provides critical consumer protections without restricting meaningful access to credit.

Full assignee liability is critical for two reasons. First, it ensures that the homeowners who are harmed by the violations in the law have full redress against the holders of their loans so that they may obtain the protections of the law. Second, it ensures that market incentives exist from the originators to the investors, for mortgage loans to be made which are sustainable for homeowners and communities. Without the pressure of potential liability, there is little cost to the investor when funding profitable, yet illegal loans. This is the dynamic which must be changed.

Ability to Repay: An ability to repay provision must be rigorous, require institutions to take into account the maximum possible interest rates on adjustable rate loans, include taxes and insurance in assessing borrower ability to repay, and consider all debts. The ability to repay provision must require documentation of income. Stated-income and low-documentation loans have been a major contributor to the foreclosure crisis since abusive lenders have been extending limited documentation loans to borrowers that clearly could not afford them. Limited documentation loans were not used because borrower income information was not available, but was used as a means to commit fraud. Your bill provides a robust ability to repay provision, which should be retained. However, it is applicable in too limited a context. We ask that it be further strengthened by adding residual income into the analysis; otherwise, low-income borrowers may meet required debt-to-income ratios while lacking sufficient actual dollars to cover basic needs.

Provisions of the Frank-Miller-Watt Bill

Our comments respond to the bill's provisions by Title. We offer the following comments and suggestions:

Title I (Mortgage Origination)

Federal Duty of Care: A federal duty of care imposed on all mortgage originators is an important component of an anti-predatory lending bill. A requirement to act with reasonable care and good faith prohibits outright fraud and placing a borrower in a clearly inappropriate loan. A duty of care requires that loan officers of depository institutions and brokers act as responsible professionals.

While a duty of care is desirable, we would have preferred a fiduciary duty imposed on mortgage originators. Financial penalties for breaching a fiduciary duty must be swift and severe enough to discourage irresponsible and fraudulent lending. Currently, abusive brokers engage in predatory lending because they can sell loans to secondary market investors and thereby escape financial penalties associated with predatory lending. Recent industry research documents that 43% of brokers using low documentation loans stated in a survey that borrowers could not qualify for loans under standard debt-to-income ratios. This survey result suggests that the brokers were not using reasonable care; instead they were placing borrowers in loans that confronted borrowers with too much debt. Using low documentation loans inappropriately appears to be a widespread industry practice, which must be stopped by a stringent federal care of duty standard. We hope that a fiduciary standard can be attached to the federal care of duty.

Anti-Steering: Steering borrowers qualified for a lower cost loans into high coast loans is a pervasive industry practice that robs borrowers of hard-earned equity. We applaud the Frank-Miller-Watt bill for prohibiting steering. Further, we strongly support the provision that prevents mortgage originators from receiving compensation, including yield spread premiums that vary with the terms and Annual Percentage Rate (APR) of the mortgage. Inducing brokers and loan officers to make higher interest rate loans by offering them extra compensation has contributed significantly to steering and price discrimination.

Your prohibition is essential. However, your remedy is overly limited. The remedy for steering a borrower into an overly expensive, inappropriate loan, must include at the least the homeowner's actual damages resulting from the steering. Further, the bill should clarify that any cap on damages included does not limit damages resulting from other claims relating from the same behavior.

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When a borrower is steered towards a loan with an APR two or three percentage points higher than the loan for which he or she qualifies, the borrower will pay tens of thousands or hundreds of thousand dollars more in mortgage costs due to the discrimination. This represents a substantial loss of wealth, which could have been used to send a child to college or start a small business. When several residents of a minority or working class neighborhood suffer price discrimination, the neighborhood loses millions of dollars that could have been reinvested in neighborhood businesses and other institutions to build wealth.

In 2003, NCRC released a path-breaking study, entitled the *Broken Credit System*, documenting price discrimination on a national level.[7] We found that after controlling for creditworthiness and housing characteristics, the amount of subprime refinance loans increased as the number of minorities and elderly increased in neighborhoods in ten large metropolitan areas. In addition to the NCRC report, two studies conducted by Federal Reserve economists found that subprime lending increases in minority neighborhoods after controlling for creditworthiness and housing market conditions.[8] The Center for Responsible Lending also used HMDA data with pricing information to reach the same troubling conclusions that racial disparities remain after controlling for creditworthiness.[9]

More recently, NCRC's *Income is No Shield against Racial Differences in Lending* released in July of 2007 found that lending disparities for African-Americans were large and increased significantly as income levels increased. Middle- and upper-income (MUI) African-Americans were twice as likely or more than twice as likely to receive high-cost loans as MUI whites in 167 metropolitan statistical areas (MSAs). In contrast, LMI African-Americans were twice as likely or more than twice as likely to receive high-cost loans as LMI whites in 70 MSAs. Moreover, MUI African-Americans receive a large percentage of high-cost loans. In 159 metropolitan areas, more than 40% of the loans received by MUI African-American were high-cost loans. Hispanics also experienced increasing disparities as income levels increased. NCRC's mystery shopping supports the data analysis and has found that brokers and lending institutions steer qualified minorities to high-cost loans.

<u>Licensing and Registration of Mortgage Originators:</u> Licensing and registration requirements for mortgage originators will ensure that consumers can identify if a originator is a legitimate business and has met state and/or federal standards. The standards that the originators are to meet must be rigorous in that they require a deep knowledge of law and industry underwriting standards. Easily-met educational

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[7] See NCRC's *Broken Credit System* at http://www.ncrc.org/policy/cra/documents/ncrcdiscrimstudy.pdf

[8] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. See also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622.

[9] Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, see http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010

requirements, for example, can provide a veneer of legitimacy to unscrupulous originators that possess only cursory knowledge of lending and are not dedicated to the best interests of the borrower. For licensing and registration of mortgage originators to be truly valuable to consumers, information about complaints against the originators must be publicly available as is -- unfortunately -- not explicitly provided for in your bill.

Remedies: Remedies must be sufficient to make a borrower whole, to fully compensate borrowers, and to expeditiously place borrowers in safe and responsible loans. The remedy in the Frank-Miller-Watt bill addresses originator abuses by establishing rewards equal to up to triple the indirect and direct compensation received by originators. The language should be clarified that the monetary damage is triple, not up to triple, the compensation received. Yet, this proposed reward will fall short in several instances to compensate for the full amount of harm experienced by a borrower and it will be insufficient to finance a new loan that enables a borrower to avoid foreclosure and succeed in homeownership.

Lenders who buy abusive loans from brokers should be clearly responsible for the actual damages stemming from abusive loans. This will ensure that lenders are very careful with whom they do business. As noted above, any remedy in this section also should not impede other remedies currently available.

Title II (Minimum Standards for All Mortgages)

Ability to Pay/Net Tangible Benefits: A strong ability to repay and tangible net benefit requirement is vital for a federal anti-predatory lending law. The ability to repay provision must assure rigorous underwriting for adjustable rate loans and must include a carefully chosen debt-to-income ratio as a threshold for determining affordable loans.

The ability to repay provision must take into account the maximum interest rate that can be charged during the first seven years of the loan, in the case of adjustable mortgage loans. To sustain homeownership, and preserve precious equity, the bill should require the underwriting standards for adjustable rate home loans to be: *At the time a home loan is made, the lender should ensure that the homeowner currently has the capacity to pay all housing related debt based on the maximum possible rate which could apply under the terms of the loan.*

Basing ability to repay on the fully-indexed rate, as in the Frank-Miller-Watt bill and in existing regulatory guidance, runs the risk of basing ability to repay on an artificially low rate when the LIBOR or other commonly used benchmark rates are low. If the House Financial Services Committee desires to use the fully-indexed rate, we urge the Committee to add a margin such as 200 basis points above the fully-indexed rate, which is the underwriting procedure mandated by Rep. Ellison's bill, H.R. 3081.

A presumption of an inability to repay when the debt-to-income ratio is above a certain threshold is a reasonable approach that does not preclude finding a loan unaffordable or abusive if the debt-to-income ratio falls below the threshold rate. A presumption of an inability to repay when the debt-to-income ratio is 50% or higher has been a widely used standard, but NCRC's experience is that this ratio may be too high. Based on our programmatic experience, a threshold ratio of 45% may be more effective in capturing abusive loans.

NCRC operates a foreclosure prevention program, the National Homeownership Sustainability Fund (NHSF), whose clients have been placed in loans beyond their ability to repay. A sample of 69 NHSF cases included calculations of the monthly housing payment-to-income ratio (front-end ratio) and the monthly total debt-to-income ratio (back-end ratio). The median front-end ratio was 35.4%. The median back-end ratio was about 50% as shown in the graph below. Standard front-end and back-end ratios for prime loans are 28% and 36%, respectively. The considerably higher ratios of the predatory loans in the NHSF sample suggest that the loans were beyond the consumers' abilities to repay, leading to financial distress and/or bankruptcy and foreclosure.

Since the median ratio was 50% for the consumers seeking assistance from NCRC's NHSF program, it is likely that a 50% debt-to-income ratio represents a breaking point in terms of making a loan unaffordable. Thus, we ask the Financial Services Committee to consider a slightly lower threshold ratio of 45%.

HSF Cases **Unaffordable Loans**

Debt-to-income Ratios

	Front-end Ratio	**Back-end Ratio**
Average	40.77%	50.28%
Median	35.43%	49.78%

The ability to repay provision should be further strengthened by adding residual income into the analysis. It is possible for low-income borrowers to meet required debt-to-income ratios but lack sufficient actual dollars to cover other basic needs including food, transportation, and clothing.

Finally, the bill's provisions relating to underwriting for negative amortization are important, however the underwriting in the bill should be based upon the full effect of negative amortization and failure to make principle payments.

Net Tangible Benefits: Considering the costs and terms and conditions of the previous and new loan, a refinance loan must offer a net tangible benefit for a borrower. Your bill appropriately stipulates that the costs of refinance loans do not exceed the amount of the new principal. Another important provision for a net tangible benefit standard is that refinance loans must legitimately lower costs for borrowers. The lower interest rate must be low enough so that the savings achieved from the lower rate pays off the fees associated with the new loan in a specified time period such as four years. If the fees of the new loan are abusive, the fees drain borrower equity and it takes several years for the interest rate reduction to pay for the costs of the new fees.

Safe Harbor for Qualified Mortgages and Limitations on Securitizer Liability: The safe harbors for qualified mortgage loans appear to provide absolute immunity for assignees, and therefore offer no meaningful remedy for homeowners with such loans, even if the loans do in fact violate the substantive provisions of this bill. Complete insulation from liability is much more restrictive than the relatively new state laws modeled on HOEPA. The new state laws generally do not prevent a private right of action for an individual homeowner when a financial institution has met a safe harbor. We reiterate here the need for homeowners to be able to bring affirmative causes of actions against the holders of their loans when the loans have been in violation of federal law.

We do appreciate the additional defenses that you set out for homeowners to use when they are in foreclosure. However, it is counterproductive federal policy to permit vindication of a federal right only when a homeowner is on the brink of losing their family home. Indeed, a solid proportion of the homeowners in distress will continue to pay on completely unaffordable mortgages – out of pride, fear of hurting their credit, or because they believe it is the only moral way of behaving. These homeowners should be able to exercise the consumer protections you are providing in this new law.

It would be an unfortunate message to send to the American public that foreclosure is the only avenue for redress against a mortgage holder who has funded a loan which violates federal law. We hope you will change this message.

The bill also seeks to create and then virtually eliminates liability for the intermediate assignees that structure the loan pools. Intermediate assignees currently can be held liable under Truth in Lending, although more clarification about a consumer's right to know who they are and that they are liable would be helpful. However, the right to cure and exemption from liability eliminate almost any effect of placing the burden on this segment of the industry to redress loans. First, a securitizer can completely escape liability for any abusive loans simply by adopting a policy of buying only qualified mortgages and qualified safe harbor mortgages, executing representations and warranties with regard to such policies, and engaging in some sampling and review of sample loans.[10]

Adopting a set of broad policies should not render any entity 100% immune. The result is that homeowners with such loans are 100% without a remedy. Moreover, an entity that buys loans outside the safe harbors will need to cure only the loans for the comparatively few borrowers who have the resources to complain after the fact of their receipt of

[10] This assumes the entity has not already escaped any accountability simply because it is an assignee and therefore can be presumed, without rebuttal, to have complied with the terms of 129B if the loan itself is a qualified mortgage or qualified safe harbor mortgage.

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abusive loans. (Any entity working just within the safe harbors, or at least claiming to do so through its policies, will not even need to cure). An entity thus can shield itself simply by opening up a small department to cure the relatively few loans that will come its way, while avoiding any significant institutional changes that would be much more expensive. Essentially, the right to cure will be simply a cost of doing business. Full assignee liability for borrowers with abusive loans is the key to market change.

The introduction of securitizer liability also introduces a dual scheme for borrowers in default. By necessity, they will continue to try to work with the servicer representing the current holder/investor to find a loan modification or other arrangement in order to stay in the home. At the same time, they will now be forced to seek any other remedy from another party—the securitizer. Additionally, while the bill contemplates the securitizer buying back the loan from the pool, it is not clear the homeowner will be in a position to enforce any such agreement. Pooling and servicing agreements usually include such provisions now, and often they are not followed.

While the section on securitization indicates that rescission is available, the bill as written does not actually provide for such a remedy. Addressing this omission will also allow for the proper remedy in the section providing for a foreclosure defense.

We understand that you are responding to concerns that assignee liability will restrict lending activity. But in addition to the research on anti-predatory law that casts serious doubts on the credit restriction thesis, the best answer these concerns may be to look at pervious experience with assignee liability. In particular, we urge you to examine what happened after 1975 when the Federal Trade Commission passed the *Preservation of Consumers Claims and Defenses Rule.*[11] That rule applies *full liability* in most circumstances to assignees of loans used to purchase goods and services. The automobile dealers and other sellers of goods, among others, argued that if the rule passed that the cost of credit would increase, credit would be more difficult to obtain, retail merchants would be hurt, financial institutions would stop purchasing consumer loans altogether, and many would be forced out of business altogether.[12] The finance companies and the banks argued that they did not want the responsibility of policing sellers and that sellers would not survive with the additional red tape, many consumers would stop paying on the loans without cause, and that the rule would interfere with free competition.[13] However, there are no serious indications that the passage of this FTC rule had any significant impact on the availability of or cost of credit. Indeed, it appears that credit availability continued to expand since the passage of this rule.[14]

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[11] 16 C.F.R. § 433, 40 Fed Reg. 53506 (Nov. 18, 1975).
[12] 40 Fed Reg. 53506, 53517 (Nov. 18, 1975).
[13] *Id* at 53518.
[14] In 1970, the total non-revolving credit in the US was approximately $124 billion; growth continued steadily through the 1970s and by December 1980, the total non-revolving credit in the US was approximately $297 billion. This growth continued notwithstanding the announcement and final promulgation of the holder rule. Source: Federal Reserve Statistical Release G.19 1970 through 1980.

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It is untrue that if the secondary market were to have full liability the industry would stop making or funding mortgage loans. Consider the massive protections consumers have against unauthorized charges in credit card transactions: the Fair Credit Billing Act promises that creditors will take the hit for all such unauthorized charges.[15] The credit card industry has not suffered from this full liability. Instead, the credit card industry has created a comprehensive system for limiting those losses. That is the same incentive that it is necessary to provide to the mortgage industry.

Defense to Foreclosure: A defense to foreclosure provision is vital. This protection is critical in all cases, but especially in jurisdictions with non-judicial foreclosure procedures, which tend to offer fewer protections to borrowers. We are appreciative of the inclusion of this provision in the bill. As we noted above, the addition of language providing the rescission remedy is essential to effectuate this provision at all.

Additionally, as we explained in the above section, the defense to foreclosure is not sufficient to protect homeowners who have been victims of violations of this new federal law. The secondary market is in the best position to stop predatory loans. If the secondary market has the incentive to insure that the loans it is buying, packaging and selling as investments are not predatory, the secondary market will figure out an efficacious way of accomplishing this.

Renters: As homeowners and investors default on their mortgages, their tenants face eviction risk, and communities face the possibility of speculators buying properties and then renting them out at a higher rate while not adequately investing in their maintenance. This cycle of eviction and disinvestment is very troubling and is appropriate for Congressional review and intervention. NCRC recommends strong protections for tenants who are in homes that are in foreclosure to ensure that they can either maintain their existing housing or have adequate time to relocate to new affordable rental housing stock. Your bill appropriately requires investors of foreclosed properties to assume the commitments in leases with renters and requires vacate notices to provide 90 days for tenants who do not have leases to move out.

Additional Standards and Requirements: We are pleased that the Frank-Miller-Watt bill is prohibiting mandatory arbitration and single premium credit insurance on all mortgages. These practices are inherently abusive and have been abandoned by major players in the financial industry. Banning these practices altogether is the next logical step. Prohibiting onerous prepayment penalties is also a critical protection since onerous prepayment penalties prevent borrowers from refinancing out of abusive loans and trap borrowers in precarious financial situations. We strongly support your provision to prohibit prepayment penalties that are applied within 90 days of introductory interest rates re-setting on ARM loans. Borrowers need sufficient time to refinance without prepayment penalties if they confront significant interest rate increases. If anything, the time period should be extended to 120 days.

[15] 15 U.S.C. § 1666.

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Right To Cure: We are quite concerned about the amendments to Truth in Lending Act's (TILA) correction of errors provision. The proposed changes would allow a cure after a borrower provides notification, as long as it is before institution of an action, and for any "unintentional violation." This has the effect of dramatically decreasing the need for responsibility on the part of originators and investors. The "unintentional violation" standard will always be the defense – then potentially requiring consumers to prove that the violation was intentional. This potentially places a level of proof on many individual borrowers which makes the litigation of standard Truth in Lending cases require evidence of a lender's intent. That is a gross increase in the necessary proof for both traditional TILA disclosure claims, as well as the more substantive provisions included in this bill. The effect will be to make all of the protections that much more elusive. Also, by allowing notification from a consumer to be the trigger to correct errors completely eliminates any incentive on the originators or the investors to look for and avoid such errors in the standard course of business. Instead the bill should be creating business incentives for business to establish their own internal safeguards.

Title III (High Cost Mortgages)

The Frank, Miller, and Watt bill would provide additional protections for loans defined as high-cost loans. The bill would define a high-cost loan as a loan with points and fees greater than 5% of the loan amount or an Annual Percentage Rate (APR) that was 8 percentage points greater than Treasury rates of comparable maturities.

For loans with APRs and points and fees greater than these thresholds, the bill would:

- Prohibit the financing of points and fees;
- Prohibit excessive fees for payoff information, modifications or late payments;
- Prohibit practices that increase the risk of foreclosure such as balloon payments and encouraging a borrower to default;
- Require pre-loan counseling

These added protections for high-cost loans are essential. NCRC's NHSF program frequently encounters loans in which borrowers do not suspect that the points and fees are excessive because they are financed into the loan. The excessive fees and points contribute to unaffordable loans.. The NHSF program has also experienced usurious fees for payoff information and stiff balloon payments. Pre-loan counseling is essential before a borrower enters into a high-cost loan. Time after time, the NHSF program assists unsuspecting borrowers who trusted the abusive broker and loan officer and did not understand the vast array of confusing terms and conditions associated with high cost loans. The borrowers felt pressured to sign for the loans because they believed they had no alternatives. Loan counselors would provide reassurance to borrowers that they have alternatives.

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The Escrow, Appraisal, and Mortgage Servicing Improvements Act of 2007

As well as prohibiting abusive lending, Congress must enact protections against abusive servicing and appraisal practices. While Rep. Kanjorski's Escrow, Appraisal, and Mortgage Servicing Improvement Act of 2007 (H.R. 3837) contains important consumer protections, new protections need to be added and certain provisions need to be enhanced.

The chief additional provision which community and consumer groups hope will be included in any mortgage servicing bill is a requirement for mandatory loss mitigation efforts before foreclosure is initiated.

Requiring reasonable efforts to avoid foreclosure and engage in loss mitigation is one critical consumer protection absent from the Kanjorski bill. NCRC and NCLC recommend that the Financial Services Committee adopt the loss mitigation procedures from Senator Reed's bill, the Homeownership Protection and Enhancement Act of 2007 or S 1386. Senator Reed's bill requires servicers to "reasonably" analyze the borrower's financial situation and to assess the feasibility of measures including forbearance, waiver or modification of loan terms and conditions, acceptance of partial payments and short sales.

Requiring reasonable efforts on the part of servicers is urgently needed since 2 million adjustable rate mortgages will have re-setting interest rates in which the initial rates will climb upward during the rest of 2007 and 2008. Current mediation efforts have been woefully lacking. Recently, Moody's reported that less than 1% of problematic subprime loans have been modified.

H.R. 3837 protects borrowers against sudden and unexpected expenses by requiring escrows for high-cost loans and loans in which borrowers have considerable debt. H.R. 3837 also appropriately requires that loan underwriting consider escrow payments when assessing borrower ability to repay the loan. NCRC's NHSF program demonstrates that a lack of escrows has contributed to delinquencies and foreclosures. Two thirds of the borrowers in a sample of loans in NCRC's NHSF program did not have escrow accounts. A number of borrowers assisted by the NHSF program experienced payment shock when they discovered that they had thousands of additional dollars in taxes and hazard insurance payments that were not covered by the loans.

Kanjorski's bill does advance protections against servicer abuses. The bill requires servicers to make efforts to contact borrowers before placing costly hazard insurance to the loan.

The force placing of property and flood insurance has led to widespread abuses in the servicing industry. Tens of thousands of homeowners are in default, with foreclosure looming, simply because of the questionable practices of force placing of insurance. There are cases where properties were force placed even when the servicer held a fully paid up escrow account, or when the servicer had in its files multiple documents proving the existence of homeowners' insurance, or even the placement of flood insurance on property sitting on the top of a mountain! Force placing of insurance is a lucrative practice for servicers which has devastatingly serious consequences for homeowners.

The bill's requirement that servicers refrain from placing insurance when a borrower confirms verbally that she or he has hazard insurance is good. Moreover, the bill would prohibit servicers from declaring a loan in default due to a borrower's failure to obtain or pay for hazard insurance. However, as promising as these additional protections are in H.R. 3837, we urge the Financial Services Committee to absolutely ban the force placing of insurance unless the borrower has been denied property insurance for some reason other than non-payment.

A common servicer abuse is not crediting the borrower with making loan payments, often resulting in loan delinquencies. The Kanjorski bill protects against this practice by requiring the prompt crediting of borrower payments. The bill also requires prompt responses to pay-off requests and prompt refunds of escrow amounts on payoff.

Importantly, H.R. 3837 creates an unfair and deceptive practices standard designed to protect consumers from fraudulent appraisals. However, without a private right of action, this protection is quite limited. Industry survey research reports that 90 percent of appraisers believe that they have been pressured to inflate their property valuation estimates. Appraisal fraud has contributed to the mortgage meltdown as lenders stretch to put borrowers into loans for homes with inflated property values. H.R. 3837 would prohibit the intimidation, influencing, or bribing of an appraiser when the appraiser is estimating property values. The bill's unfair and deceptive practices standard would be significantly strengthened, however, if lenders were held liable for fraudulent appraisals, and homeowners had a clear right of action under the bill to sue the appraisers.

Conclusion

Some observers will caution legislative and regulatory restraint, claiming that economic cycles are inevitable and that the market will wring out the worst excesses of abusive lending. While economic cycles occur, the extent of dangerous lending suggests that fundamental market failure is occurring that cannot be corrected by the market itself. Economists assert that market outcomes will be inefficient when economic actors fail to internalize the negative externalities of their actions. In other words, the mortgage meltdown was caused when industry participants did not internalize the harms of their actions because they did not suffer financial penalties commensurate with the harms. Brokers and loan officers did not suffer financially when they issued predatory loans because they sold their loans to the secondary market. Secondary market investors did not suffer financially either because they developed sophisticated means to diversify risk.

In this context, fiduciary duty imposed on originators and assignee liability are critical mechanisms to provide financial incentives for industry actors to refrain from predatory lending. We therefore urge the House Financial Services Committee to adopt fiduciary duty and full assignee liability.

While asking that the Committee adopt full assignee liability, we applaud Representatives Frank, Miller, and Watt for not preempting state law and for building in a number of vital protections in the bill. Full assignee liability and no preemption of state law would work together to ensure that the robust protections established by the bill can be enforced. The bill's ability to repay provision is a good standard that should be bolstered by adding an analysis of residual income and requiring consideration of the maximum possible rate in the case of ARM loans. Other important provisions of the bill include the anti-steering provision; prohibitions on onerous prepayment penalties, single-premium credit insurance, and mandatory arbitration for all mortgages; prohibitions on financing fees for high-cost mortgages; counseling requirements for high-cost mortgages; and protections for renters residing in foreclosed properties.

We also hope that the House Financial Services Committee attaches H.R. 3837 to the Mortgage Reform and Anti-Predatory Lending Act of 2007. H.R. 3837 requires escrows for high-cost mortgages and mortgages with large debt loads. Importantly, the bill addresses force placed insurance and appraisal fraud; we hope the Committee considers our recommendations for strengthening these provisions.

Homeownership remains the only or primary source of wealth for most Americans. Protecting families and communities from the scourge of predatory lending must be one of the most important priorities of Congress. Predatory lending devastates entire communities, from low-income to middle-class neighborhoods. Abusive lending is now even impacting the global economy. Congress can no longer rely on prodding the regulators and the industry to adopt more guidelines and best practices. A strong national law is needed that will provide comprehensive consumer protections and deter abusive lenders by providing swift financial penalties for predatory lending.

Testimony presented on behalf of the

Appraisal Institute
American Society of Appraisers
American Society of Farm Managers and Rural Appraisers
National Association of Independent Fee Appraisers

Before the House Committee on Financial Services

On

"Legislative Proposals on Reforming Mortgage Practices"

Presented by

Alan E. Hummel, SRA
Chair, Government Relations Committee
Appraisal Institute
Senior Vice President and Chief Appraiser
Forsythe Appraisals, LLC
Minneapolis, MN

October 24, 2007

October 24, 2007

Joint Testimony Presented by

Alan E. Hummel, SRA

On Behalf of the

Appraisal Institute

American Society of Appraisers

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Before the

Committee on Financial Services

United States House of Representatives

Chairman Frank, Ranking Member Bachus and members of the Committee on Financial Services. I am Alan E. Hummel, SRA, Senior Vice President and Chief Appraiser of Forsythe Appraisals, LLC in Minneapolis, Minnesota. I am the Chair of the Appraisal Institute's Government Relations Committee and Past President of the Appraisal Institute. Today, I am pleased to be here on behalf of the Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and the National Association of Independent Fee Appraisers, the four largest professional appraisal organizations in the United States, representing 30,000 real estate appraisers.

Thank you for the opportunity to testify before this joint subcommittee hearing on "Legislative Proposals on Reforming Mortgage Practices". There is a bill currently before this committee that would protect consumers and financial institutions from mortgage, by addressing shortcomings in the appraisal regulatory structure, H.R. 3837, the Escrow, Appraisal, and Mortgage Servicing Bill, co-authored by Representatives Paul Kanjorski, Barney Frank, Paul Hodes and Charlie Wilson. We appreciate the work of the bill sponsors because mortgage fraud is an issue that deserves the attention of Congress. It is also an issue that requires a holistic solution, as it involves all aspects of the real estate industry, including real estate appraisal. H.R. 3837 specifically addresses appraiser and appraisal-related concerns by modifying Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), the law enacted by Congress in 1989 which created the current appraiser regulatory structure. We support these provisions, and we urge they be enacted.

For years, professional real estate appraisers have been warning Congress about the endless schemes perpetrated on consumers and the financial markets by real-estate rogues, including some mortgage brokers, realty agents, and property flip investors. Bad appraisers deserve blame, too. Our organizations have been leading the fight to protect our members and ultimately the public from intense pressure from commission paid participants to make these deals work. This intense pressure had undermined the integrity of safeguards which have been designed into the appraisal component of the lending process for the past 75 years. Appraisers with integrity have found themselves frozen out of the market while weak, inexperienced appraisers became the darlings of some lenders. Too often, appraisers, either through incompetence or by turning a blind eye, have helped facilitate bad mortgage loans. The entire real estate industry faces critical problems. We urge Congress to curb these abuses.

The appraiser is a vital independent service provider in mortgage transactions. Our fees are not contingent upon whether the loan goes through or based on the loan amount. Independent, competent and qualified real estate appraisers are a crucial safeguard to this portion of our economy. A professional appraiser's objectivity, experience and ethics are fundamental in ensuring that participants in residential and commercial real estate mortgage transactions know the value of the real estate involved and understand the risks inherent in collateral lending. It is of paramount importance that an appraiser be properly qualified, adequately trained and have sufficient experience in the type of property appraised.

Unfortunately, mortgage fraud exists, and in many of our communities it is rampant, costing consumers, lenders and taxpayers more than $1 billion annually[2] and suspicious activity

[1] *Financial Crimes Report to the Public.* (2005, May). Criminal Investigative Division, Federal Bureau of Investigation. Retrieved from http://www.fbi.gov/publications/financial/fcs_report052005/fcs_report052005.htm#d1

reports have increased an astounding 1,411 percent since 1997[2] according to the FBI and Department of the Treasury respectively. Loan fraud also threatens our nation's communities, leaving individuals with overvalued properties and burdensome loans. Artificially inflated sales can cause property taxes to rise while true property values decrease due to foreclosures, abandoned houses and uncared-for properties.

We are not happy to report that mortgage fraud can be perpetrated because of faulty appraisals. For this reason, we believe that any legislation addressing abusive mortgage lending practices must include reforms for the appraiser regulatory structure. Specifically, we believe appraiser-related mortgage fraud continues largely because of the following reasons:

- Unscrupulous third parties are allowed to pressure appraisers to meet predetermined values;
- Appraiser regulators provide inadequate oversight over licensed appraisers;
- Very little attention is paid to mitigating appraisal problems through improving appraisal quality.
- In some areas of lending, appraisals have been reduced from an important safeguard role to merely a speed bump in the process of closing a loan.

Proposals addressing these issues are included in H.R. 3837, specifically in Title IV. I am happy to provide further explanation of our position below.

Inappropriate Pressure of Appraisers

Appraiser pressure has received a great deal of media attention in recent months, and it was the subject of an independent study conducted earlier this year by the October Research Corporation[3]. This study found that 90 percent of appraisers were pressured by mortgage brokers, lenders, realty agents, consumers and others to raise property valuations to enable deals to go through. This was nearly double the abuse findings of a similar study three years ago. Moreover, the survey found that 75 percent of appraisers reported "negative ramifications" if they

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[2] *Mortgage Loan Fraud, an Industry Assessment based upon Suspicious Activity Report Analysis.* (2006, November). Financial Crimes Enforcement Network, Regulatory Policy and Programs Division, Department of the Treasury[2].

[3] National Appraisal Survey, October Research Corporation, December 2006. www.octoberresearch.com

did not cooperate, alter their appraisal, to provide an artificial valuation. The prime culprits of pressure, according to the survey, were mortgage brokers (71 percent), real estate agents/brokers (56 percent), consumers (35 percent), lenders (33 percent), and appraisal management companies (25 percent). Pressure comes from every direction. We must do everything we can to ensure an independent appraisal process in mortgage transactions. We cannot do that in a market half regulated.

Pressure is especially strong when appraisals are delivered to parties whose compensation depends on getting people to the closing table to complete the sale and mortgage. If the loan doesn't close, these parties don't get paid. They do what they can to be sure they get paid.

Unfortunately, these parties with a vested interest in the transaction are often the same people managing the appraisal process within many financial institutions, and therein is a terrible conflict of interest. In this situation our members experience systemic problems with coercion. Appraisers are ordered to doctor their reports or else never see work from those parties again.

Coercion can be subtle or blatant. Some parties boldly demand overlooking material issues or property conditions to make the appraisal arrive at the desired number - or else. Such direct threats typically occur over the phone or through an informal communication. And as a result, it is very difficult to document instances of inappropriate pressure on appraisers.

I have personally experienced such threats. On several occasions clients have told me that failing to comply with their wishes will result in my firm's not being paid or never receiving work from that institution in the future. In these cases, for not bowing to these pressures, I lost clients and was not paid for my services. I am one of many appraisers with this experience.

Our organizations are also concerned about the subtler practice of "blacklists" or "exclusionary appraiser lists," particularly when they are used as levers to pressure appraisers. It is one thing to maintain a list of reputable businesses to work with, or to maintain a list of firms to avoid as the result of poor performance; it is another to place an appraiser on an exclusionary list for no other reason than the appraiser failed to hit a predetermined value. Worse yet, these blacklists are shared by lenders in a formal, organized system with no notice provided to the affected appraiser, nor any ability of that appraiser to defend his or her reputation.

Subtle tactics may fall short of outright coercion, but the implication is the same. For instance, it is common for a client to ask an appraiser to remove details about the material condition of the property to avoid problems in qualifying the home for a certain type of mortgage. However, this omission amounts to a violation of appraiser ethical requirements. Just last week, I received the following email from a broker client:

Greetings,

I have a question on the following: "...with the exception of an area of the front porch flooring which decayed. According to the owner, the basement gets some dampness during storms through the newer area of the foundation..." Page 1of 6.

Do you guys know Appraisals 101? This statement should never be on the report. Now we face a big problem with the lender here and this makes the customer very unhappy as well. This decayed area, is this essential to notice? What if it was covered with a rug?

I need to know what to do here. How can you help us get this in line? What is the exact? problem? What is cost to cure? Anything?

Please respond ASAP Thanks.

I can assure members of the Committee that the cost to "cure" the decaying front porch flooring is a little more than the cost of an area rug to cover up the damage.

Weak or non-existent enforcement

Where there are few rules prohibiting appraiser coercion, little enforcement takes place. Outside of some diligent law enforcement officials and observant legislators who have recognized the importance of maintaining appraisal independence, we see very little enforcement occurring on these issues. For several years, our organizations have highlighted the importance of this issue on the state level, achieving some results.

For instance, the issue between 40-plus states and Ameriquest largely involved breakdowns in appraisal independence. Investigators found that, between 1999 and 2005, Ameriquest employees deceived thousands of consumers with high-pressure tactics to boost their monthly quotas and commissions. Consumers accused the company of engaging in unfair and deceptive lending practices such as misrepresenting the actual amount of interest, inflating their home appraisals, delaying funding of consumers' loans after closing and failing to clearly disclose fees or penalties associated with paying the loans off ahead of schedule.

In the settlement, Ameriquest denied all allegations but agreed to adhere to new standards to prevent what the states alleged were unfair and deceptive practices. Ameriquest had to overhaul its appraisal practices by removing branch offices and sales personnel from the appraiser selection process, by instituting an automated system to select appraisers from panels created in each state, by limiting the company's ability to get second opinions on appraisals, and by prohibiting Ameriquest employees from influencing appraisals.

In the past twelve months, four states passed laws prohibiting brokers and lenders from pressuring appraisers to reach value. This month, the California governor signed SB 223 which explicitly forbids persons involved in the real estate transaction from pressuring an appraiser to hit a target value. The bill punishes violators with license suspension or revocation and with potential civil action. Last June, Ohio passed a law that prohibits a person or business from improperly influencing the judgment of an appraiser with respect to value. Following suit, the Attorney Generals of two other states, backed by our chapters, pushed for the passage of similar provisions. The Colorado legislature passed a bill that says no person shall improperly influence an appraiser, while Iowa passed a more extensive provision, banning appraiser coercion or attempted appraiser coercion. These laws join the list of state laws protecting appraisers from undue pressure, in Arkansas, Kansas, North Carolina, Utah and West Virginia. Legislatures and public officials in other states are exploring similar actions.

The new Ohio predatory lending law has produced the recent indictments of 10 mortgage brokers, mortgage lenders and an appraisal management company, charged with improperly influencing the appraisal process. New York's attorney general is now investigating whether home appraisers were improperly pressured by mortgage brokers and lenders to inflate estimates, damaging the New York real estate market's integrity.

Outside of these cases, we are not aware of any administrative action taken by a state regulator of mortgage lenders, mortgage brokers or others involving improper influence over the appraisal process. However, this may change as the result of the recent laws passed in the last year, and several others currently pending in Michigan and Florida.

By strictly prohibiting coercion of appraisers by interested third parties, H.R. 3837 makes it clear that appraisers are to remain objective third parties in a transaction.

Oversight and Enforcement of Licensed Appraisers

Another area that deserves more scrutiny and attention is enforcement by federal and state appraiser regulators. One of the results of the savings and loan crisis of the late 1980s was the passage of FIRREA in 1989, and its Title XI established the current appraisal regulatory structure. While created with the best of intentions, the attempt to tie federal and state regulators and the private sector together to oversee appraisers in the U.S has left us, eighteen years later, with a configuration that is, without question, extremely convoluted.

Title XI created the federal Appraisal Subcommittee to oversee the activities of the state appraisal boards and commissions. Yet, the only real power the Appraisal Subcommittee has over state appraisal boards is the authority to "decertify" a state if it is found to be out of conformance with Title XI. This specific power is called by some the "atomic hammer," because if it were invoked, virtually all mortgage lending in that state would cease. Because of its severity, the Appraisal Subcommittee has never used this power, and it is unlikely that it ever will. This is why we support the concept put forth in H.R. 3837 that would grant the Appraisal Subcommittee authority to impose interim sanctions and suspensions on the State appraiser certifying and licensing agencies develop sanctioning power of state appraisal boards through a public rulemaking process. Such powers include the ability to write rules and regulations, powers currently not granted to the Appraisal Subcommittee.

State Appraisal Board Funding

In addition, many state appraisal boards are having acute difficulties maintaining effective regulatory systems. According to the 2006 Annual Report of the Appraisal Subcommittee, 60 percent of the state appraisal regulatory agencies failed to uphold their responsibilities in conducting enforcement activities. Time and again, most states relate that while they do their best to keep up with the demanding workload, they simply don't have the resources to perform effectively.

That lack of resources creates a system that allows some unscrupulous and unqualified appraisers to continue practicing and provides little or no recourse for their actions. Some of these appraisers have been linked to mortgage fraud schemes throughout the country. For example, within the last few years, a real estate appraiser in New York was found guilty and convicted of a felony for grossly inflating appraisals. His state license was revoked, and he served a jail sentence for one year. Upon his release, he challenged the state appellate court to have his license reinstated. The court overturned the ruling of license revocation, determining that he had served his time sufficiently and that he must return to becoming a "beneficial member of society." Amazingly, this fraudulent appraiser charged with participating in numerous land-scam schemes is now a practicing appraiser--sanctioned--in New York.

New York is not alone in handling such cases carelessly. In Maryland in June of 2003, an appraiser who pled guilty to appraisal fraud admitted that the government lost between $500,000 and $800,000 due to his actions. In the fall 2003, he applied to renew his license. On the online application, he answered "no" to whether or not he had ever been convicted of a felony. According to his attorney, he answered the question honestly because in the federal system, one is not convicted until sentenced, and the appraiser was not sentenced until February 2004. Thus the Maryland Commission of Real Estate Appraisers and Home Inspectors renewed his license last October for another three years. A spokesperson for the Maryland Commission said to the Baltimore Sun, "All we have to go by is the honesty of the licensee. We are not required to perform background checks; moreover, the financial and personnel resources are not available at this time."

The Government Accountability Office conducted a lengthy investigation on the appraiser regulatory structure, and one of the findings in their report was that funding of state appraisal board activities was a major hindrance to enforcement. A GAO survey of state appraisal boards reported resource limitations as the primary impediment in carrying out their oversight responsibilities. For example, of the 54 states and territories that responded to the survey, 26 (48 percent) reported that the current number of investigators was insufficient for meeting its regulatory responsibilities, 37 (69 percent) cited a need for increasing the staff directed at investigations, and 22 (41 percent) cited a need for more resources to support litigation.

According to this survey, the average state appraisal board had approximately three staff members who were responsible for overseeing almost 2,000 appraisers. Many of these state agencies reported that they needed to share resources—administrative staff, office space, investigators, or all three—with other state agencies in order to perform their Title XI duties. The majority of states sharing resources were sharing investigators, who often had no real estate appraisal experience. The survey results indicated that investigations of complaints about problem appraisers suffered most from these shortages. The GAO report recommended that the Appraisal Subcommittee explore potential options for funding or otherwise assisting states in carrying out their Title XI activities, particularly the investigation of complaints against appraisers. We are not currently aware of the status of this directive.

Presently, the Appraisal Subcommittee's operations are funded exclusively by individual state certified and licensed appraisers through license fees collected by states appraisal boards. Individual appraisers are assessed a $25 annual fee passed through to the Appraisal Subcommittee, which has resulted in a sizable reserve fund that exists with no identified purpose. The Appraisal Subcommittee told the GAO that it did not believe it had the legal authority to use these funds for grants to state appraisal boards. We see a few options available to Congress in this area:

- Granting the Appraisal Subcommittee the authority to establish and manage a grant program to state appraisal boards for the purpose of conducting enforcement activities;

- Requiring state appraiser licensing fees to be used for state appraiser licensing and enforcement. Currently, it is common for appraiser licensing fees to go into a state's general fund, causing the state appraisal board to compete with other state discretionary programs for funding. Self funded Boards are found to have significantly more enforcement capability.
- Requiring the Appraisal Subcommittee to add "funding" as one criterion it looks at when monitoring a state program.

We encourage this committee to explore these options to help with the current state appraisal board funding crisis.

It is our view that problem appraisals are being allowed, and in some ways even encouraged, by a regulatory structure that promotes lax enforcement and ineffective oversight. H.R. 3837 would provide the Appraisal Subcommittee with a more robust oversight system for state appraisal programs, including a full range of supervisory sanctioning powers over state appraisal regulators. We believe this modification, if implemented fairly and through an open and public process by the Appraisal Subcommittee, will help encourage state appraisal boards to take action against unethical and fraudulent appraisers and improve enforcement in our profession.

Increasing Appraisal Quality and Professionalism

Important for discussions about new laws and increasing various federal and state enforcement powers is the need to mitigate problems before they occur so that less enforcement needs to take place. This is true in the real estate industry and appraisal community, where there is a great deal of competition and cost and turnaround times are critical to the success of a business. As they say: "You get what you pay for." We believe this to be true in the appraisal community where the cheapest and fastest appraisal may not be the best or most accurate appraisal. While cost and turnaround times should always be factors in a business decision, we believe quality should be as well.

An important goal of FIRREA was to ensure that appraisals are performed by competent appraisers. However, in practice, FIRREA has had the opposite effect because it stresses minimum qualifications. This emphasis has severely curtailed the continuing development of professionalism in the appraisal community. As we reflect upon FIRREA, it is clear that the requirements for licensing and certification were set too low.

FIRREA unfortunately settled for a minimum level of education and experience and failed to recognize the need for continuing professionalism beyond the licensed minimum. Accordingly, appraisers who have met only minimum state licensing and certification requirements tend to be less experienced and less qualified than appraisers with professional designations; 84 percent of users of appraisal services say this is the case.

In a poll conducted recently by the Appraisal Institute of significant users of appraisal services from which the above-mentioned statistic is gleaned, fully 50 percent responded that the quality of appraisal services and appraisal reporting has declined, whereas only 28 percent said appraisal services and reporting have improved. This is consistent with discussions various appraisal organizations have had with users of appraisal services for the past several years.

Interestingly, though, many of these users perceive the possession of a license to be the only necessary qualification on which to base whether or not an appraiser is "qualified" to perform an assignment, and stop short of fully considering the issue of competency for a particular appraisal.

It is our view that the culprit, at least in part, is a provision formulated against designated appraisers contained in (Section 1122(d)) of FIRREA, ironically referenced as the "Anti-Discrimination" clause. Under this provision federal financial institution regulatory agencies may not exclude a licensed or certified appraiser from consideration for an assignment in a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization. Unfortunately, some financial institutions and individuals around the country have misinterpreted this clause to mean that users of appraisal services cannot establish qualifications criteria that would permit any consideration of an appraiser's membership in a professional organization. This misinterpretation is inconsistent with FIRREA's intent to enhance the quality of appraisal services and harms the public by discriminating against appraisers who hold hard earned professional designations and who may be the very best qualified to perform a particular assignment. Under this misinterpretation, for example, a federally regulated financial institution would not be able to consider a professional designation in deciding whether to award an assignment, despite the fact its achievement represents a strong commitment to professionalism.

While minimum standards and qualifications are a good place to start, limiting clients to only the minimally qualified makes no sense. Currently, nearly 40 percent of the approximately 80,000 licensed and certified appraisers in the United States belong to a professional appraisal organization, clear evidence that greater professionalism is being sought by many practitioners. H.R. 3837 would make certain that professional designations can be considered by clients to help determine an appraiser's proficiency. This would not exclude anyone without a designation from receiving an assignment, but rather promote professionalism for the industry and place an emphasis back on quality.

Education & Best Practices

The industry as a whole must improve communication and understanding among the components of real estate financing. Lenders and brokers ordering appraisals should understand basic appraisal processes, while appraisers should understand how their work product is being used by lenders and brokers and for underwriting purposes. Consumers deserve to have a full understanding of the documents they are signing. They should know whether multiple appraisals were performed for their loan, and why they were ordered. We support more resources being applied to consumer education about the mortgage process.

We are circulating an industry-wide statement of "best practices" on real estate appraisals and mortgage lending, which we believe is crucial to educate all parties involved about the importance of an independent appraisal process. We hope we can work with our industry partners to jointly develop and adopt such a statement for all major participants involved in the mortgage lending appraisal process.

Conclusion

Our organizations have long held that current law relative to appraiser licensing and certification is in need of modification and revision, and that Congress should consider and enact legislation designed to uphold integrity in the real estate valuation process while protecting government-related financial interests and consumers. We have advocated for a regulatory system where federal and state appraiser regulatory bodies are provided the resources and authority necessary to fulfill vital oversight of the profession. We have also made a case for professionalism to be fostered and encouraged and for states to streamline their operations to allow for the efficient flow of commerce.

Any legislation directed at curbing and preventing predatory lending and mortgage fraud must address current weaknesses in the appraiser regulatory structure. H.R. 3837 addresses these concerns by prohibiting inappropriate pressure of appraisers, providing greater accountability of federal and state appraiser regulators and promoting professionalism among appraisers. We stand prepared to work with Congress, consumer groups, and banking interests to help secure its passage.

Thank You

LENDERS One A National Alliance of Mortgage Bankers

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STATEMENT OF SCOTT STERN, CEO,
LENDERS ONE/NATIONAL ALLIANCE OF INDEPENDENT MORTGAGE BANKERS

RE: **--Mortgage Reform and Anti Predatory Lending Act of 2007 (Frank Bill)**
--Escrow, Appraisal, and Mortgage Servicing Improvements Act (Kanjorski Bill)

On behalf of the nations independent mortgage bankers, we commend Chairman Frank on the introduction of the "Mortgage Reform and Anti Predatory Lending Act of 2007, and Chairman Kanjorski on the Escrow, Appraisal, and Mortgage Servicing Improvements Act (H.R. 3837). Lenders One/NAIMB supports the key provisions of these bills, and will work with the Congress on certain changes to ensure timely passage.

The mortgage finance system is suffering today above all from a crisis of confidence – lack of confidence by borrowers that they will get a fair loan, lack of confidence by investors that that the risks of mortgage securities are accurately and fully disclosed, and lack of confidence in the accuracy of appraisals. Chairman Frank and Kanjorksi's bills take important steps to shore up confidence in the mortgage system through increased disclosure, uniform lending guidelines, minimum standards for mortgage originators, and enhanced appraisal and servicing protections. While these bills are not perfect, we believe that the long term vitality of the mortgage market requires a more transparent relationship with borrowers and investors which the Frank and Kanjorski bills would achieve.

NATIONAL ALLIANCE OF INDEPENDENT MORTGAGE BANKERS

Independent Mortgage Bankers Support:

- **State or federal licensing and registration for all mortgage originators, including depository institutions.** We commend Chairman Frank for not creating an agency or fiduciary relationship between originators and borrowers. Licensing requirements provide consumers with the confidence that training and loan officer standards will be uniform regardless of whether the borrower visits a broker, mortgage banker, or bank loan officer.

- **Ability to Repay Standard.** The bill would require creditors to make a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan (including all applicable taxes, insurance, and assessments). We believe that no lender should make a loan to a borrower who does not have a reasonable ability to repay the loan. Our lenders strive to meet this standard and believe it should apply to the lending industry as a whole. We recognize that Chairman Frank has sought a middle ground by rejecting a subjective "suitability standard" in favor of a well defined ability to pay standard, which is a commonly accepted underwriting standard.

- **Accountability of Securitizers.** Securitization has proven to be an effective engine for attracting significant investment into the mortgage markets. However, failure to have accurate information about mortgage pools has resulted in ill-informed investor decisions. The Frank bill addresses this by creating a safe harbor from securitizer liability for failure to meet the ability to repay standard. The safe harbor applies to securitizers who do reasonable due diligence of the mortgage pools they securitize. There is no liability for investors in loan pools. Lenders One/NAIMB believes that the Frank bill strikes a reasonable balance between the interests of investors and the interest in ensuring accountability throughout the mortgage process. Lenders One/NAIMB believes the goals of the bill would be strengthened by adding that the due diligence should be conducted by an independent third party.

- **Mandatory Escrow For Certain Loans.** Consumers with high cost loans, those with low down payments or high debt to income ratios can find themselves strapped to meet payments for taxes and insurance without proper planning. Moreover, Fannie Mae "considers it a predatory practice when a lender rarely, or never, establishes escrows for blemished credit borrowers." For these borrowers, the Kanjorski bill would require a mandatory escrow for taxes and hazard insurance. Lenders One/NAIMB believes that this provision would reduce delinquencies and defaults, especially for subprime borrowers.

- **Appraisal Reforms**: Accurate, unbiased appraisals are critical to ensuring that home values are accurately reflected in mortgage securities. Inflated home values also lead borrowers to borrower more than the home may be worth, leading to increased defaults in a flat or declining housing market. The Kanjorksi bill addresses these problems by improving appraisal standards, including:

--written appraisals based on physical inspection for high cost mortgages,
--providing the borrower with a copy of the appraisal, and
--the creation of federal appraisal independence standards to guard against undue pressure on appraisers

The National Alliance of Independent Mortgage Bankers (NAIMB) is the voice of the independent mortgage lender on regulation, legislation and government activity. The group was founded by Lenders One, the nation's leading mortgage cooperative and collectively the 9th largest mortgage originator in the country. The 100 member companies of Lenders One/NAIMB constitute the nation's largest alliance of independent mortgage lenders, representing over 6,000 employees serving every state. Lenders One originates $40 billion in mortgage loans to make homeownership possible in communities throughout the United States.

WRITTEN STATEMENT OF

MAUREEN MCGRATH

ON BEHALF OF THE NATIONAL ADVOCACY

AGAINST MORTGAGE SERVICING FRAUD

SUBMITTED TO THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING ON

LEGISLATIVE PROPOSALS ON

REFORMING MORTAGE PRACTICES

HOUSE BILL 3837

THE "ESCROW, APPRAISAL, AND MORTGAGE SERVICING

IMPROVEMENTS ACT"

OCTOBER 24, 2007

Distinguished members of the Committee, allow me to introduce myself. My name is Maureen McGrath, and I submit this statement on behalf of the National Advocacy Against Mortgage Servicing Fraud. I wish to thank you for holding this important hearing to examine the proposed Escrow, Appraisal, And Mortgage Servicing Improvements Act. I would also like to extend a special thank you to Congressman Kanjorski for keeping this issue in the forefront of his thoughts, and in bringing this vital bill to life in an attempt to protect not only the rights of his constituents in the Poconos and nationwide, but the rights of investors in the mortgage securitization market.

What you have before you is a bill that places into effect safeguards that will protect not only the rights of homeowners, but the housing market, the ability of financial institutions to continue to offer financial assistance to homeowners and potential homeowners in the form of affordable mortgages, and the continued confidence of the investors in the various forms of securitization of the notes connected with the financing of homes.

In June, 2004, I and other interested citizens testified before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises field hearing on "Broken Dreams in the Poconos". At that point in time, mortgage servicing fraud was barely being recognized, and the Curry v. Fairbanks litigation was newly filed in Massachusetts. My testimony encompassed the illegal acts perpetrated by Fairbanks Capital on unsuspecting homeowners, and the drastic effects their illegal maneuverings were having on said homeowners. In that testimony, I warned of the potential dangers that mortgage servicing fraud could have on the real estate market as a whole, and the ability of financial institutions to continue to fund mortgages for people with less than perfect credit. Those dire warnings have now come to pass. We have seen the collapse of hedge funds which incorporated so-called "sub-prime" notes, and the effect the collapse of those funds have had on the stock market. What must be realized is that not all sub-prime loans are non-performing nor are all prime or "A paper" loans performing. Instead, it must be understood that what we are seeing is a combination of poor underwriting, inflated and fraudulent appraisals, mortgage servicing fraud, and deception.

As an example, I draw your attention to the much-heralded *Curry v. Fairbanks* Class Action. Although Fairbanks entered into an agreement for Best Practices with the FTC, what was hidden beneath the surface was the continued illegal acts of Fairbanks. Litigation, brought by investors of several REMIC's, is now ongoing concerning practices that allowed Fairbanks to earn an improper windfall in various ways. First to the extent Fairbanks collected late and other fees from borrowers, Fairbanks kept them as part of its servicing compensation. Second, to the point that Fairbanks made servicing advances, Fairbanks was allowed to be reimbursed from "monthly excess cash flow" at the expense of the certificate holders. Third, Fairbanks was allowed to be reimbursed for "servicing advances" from the liquidation of said loans. This systematic bilking of borrowers led to a reduction of the liquidation of proceeds payable to the certificate holders, and inflation and overstatement of deficiency balances.

Advocates have also seen, and are following closely, the continued practice of one servicer, EMC Mortgage, a subsidiary of Bear Stearns, to create fraudulent documents in foreclosure actions. In one such case, *Wright v. EMC*, filed in Collin County, Texas, Wright successfully fought off foreclosure attempts by EMC for ten years, until EMC reached back in time, and discovered a note that was assumed by the RTC. Because of the confusion and various other issues of that time, many notes held by RTC were never marked "satisfied" when the properties were sold to new owners. Such was the case in *Wright v. EMC*. EMC reached back to the RTC Note, and through various fraudulent documents, convinced the court that the note they were foreclosing on was the note once held by the RTC in the developer's name, and not the Wright note. Mr. Wright was evicted from his home this summer. Other cases, still ongoing, reveal that EMC has consistently filed documents claiming ownership of notes prior to the entity from which EMC purchased the notes ever had legal title to either the notes or in certain cases, the REMICs.

In addition, we still have on-going litigation dealing with Fairbank's placing of force-placed insurance on various residences prior to the *Curry* settlement. The placing of said force-placed insurance placed the homeowners in default, and today, years later, these innocent and harmed individuals still have not recaptured a normal life and are still fighting for their rights to stay in their homes.

The Committee must focus on the fact that investors have lost their confidence in residential mortgage securities and have reduced their participation in the secondary mortgage market. Such a loss of confidence has occurred because investors feel that disclosure has been inadequate, they have suffered losses from issuer or servicer fraud, and they may become subject to assignee liability for predatory lending practices. Of particular note, is the fact that some subprime lenders have committed servicing fraud to avoid repurchasing loans that suffered early payment defaults (i.e., the lenders made payments on behalf of the borrowers in order to avoid reporting the loan as delinquent). The bill you have before you contains safeguards that will restore the confidence of investors, and the required studies will be far reaching in determining if servicers are using any other illegal or subversive practices in order to achieve illegal windfalls.

I urge the Committee to recommend approval of this bill at the earliest possible opportunity. This concludes my statement. Thank you for your time and consideration.

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October 16, 2007

The Honorable Paul Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises
House Financial Services Committee
2188 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Kanjorski:

On behalf of over 1.3 million members of the National Association of REALTORS®, I want to convey our support for your bill H.R. 3837, the "Escrow, Appraisal and Mortgage Servicing Improvements Act" (EAMSIA). NAR commends you, House Financial Services Chairman Barney Frank (D-MA) and Representatives Charlie Wilson (D-OH) and Paul Hodes (D-NH) for your leadership in introducing EAMSIA, which brings much needed improvements to the appraisal industry and will mitigate many contributing factors to our current delinquency and foreclosure crisis.

Irresponsible lending, mortgage servicing and appraisal practices are significant problems that far too many homebuyers now face and, if allowed to continue, will have a devastating effect on our nation's communities. NAR believes the lack of escrow or impound accounts, a common practice for subprime mortgages, is especially problematic for more risky borrowers because it requires families already stretched financially to save thousands of dollars or more to cover property taxes and hazard insurance.

According to the Center for Responsible Lending, many abusive lenders and mortgage servicers purposely do not require subprime borrowers to establish escrow accounts because the added monthly cost would push borrowers above a manageable debt-to-income ratio. NAR supports EAMSIA's approach to mitigate such lending and loan servicing abuse by requiring that certain mortgages have an escrow or impound account established at the time of origination to cover property taxes and insurance. We are also pleased that the bill requires all consumers, regardless of whether they are required to have an escrow account, to receive specific written disclosures advising them of their financial responsibilities associated with paying property taxes, hazard insurance and other periodic payments.

NAR also believes a strong and independent appraisal industry is vital to restoring faith in the mortgage origination process. H.R. 3837 strikes an appropriate balance by strengthening the accountability and oversight of appraisers while also creating new consumer protections such as allowing borrowers to obtain a copy of all appraisals prior to closing.

Recent studies have indicated that up to 90% of appraisers have been asked to hit a targeted value, while 70% of appraisers feared that if they did not meet that target, their business would be harmed. EAMSIA strengthens the independence of the appraisal process by ensuring appraisers serve as an unbiased arbiter of a property's value for the buyer, seller, lender, investor and other market participants.

National Association of REALTORS® supports responsible lending, mortgage servicing and appraisal practices. We stand ready to work with you, Chairman Frank and Representatives Wilson and Hodes to pass H.R. 3837, which offers important consumer protections to ensure the dream of homeownership that REALTORS® help fulfill does not turn into a family's worst nightmare.

Sincerely,

Pat V. Combs

Pat V. Combs, ABR, CRS, GRI, PMN
2007 President, National Association of REALTORS®

cc: The Honorable Barney Frank
The Honorable Charlie Wilson
The Honorable Paul Hodes

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington DC 20429

OFFICE OF THE VICE CHAIRMAN

December 11, 2007

Honorable Gregory Meeks
House of Representatives
Washington, D.C. 20515

Dear Congressman Meeks:

I am writing in response to your question at the recent hearing of the House Financial Services Committee entitled, "Legislative Proposals on Reforming Mortgage Practices." During the hearing, you asked whether recent losses reported by Merrill Lynch would affect the Deposit Insurance Fund. I appreciate the opportunity to respond on behalf of the Federal Deposit Insurance Corporation.

As you know, Merrill Lynch publicly reported a third quarter loss of $2.3 billion that was attributed to approximately $7.9 billion in investments in mortgage-related assets and structured finance instruments. This loss represented the consolidated operations of a number of financial services business lines within the Merrill Lynch subsidiary structure. These business lines offer a range of products to institutional and individual investors.

Within its subsidiary structure, Merrill Lynch operates two insured depository institutions, Merrill Lynch Bank, USA, a state-chartered industrial loan company in Utah, and Merrill Lynch Bank & Trust Co., FSB, a federal savings association.

Merrill Lynch Bank, USA, reported $77.6 billion in total assets and $278 million in net income for the third quarter. From the second to the third quarter 2007, its estimated insured deposits rose $112 million, from $40.65 billion to $40.76 billion.

Merrill Lynch Bank & Trust Co., FSB, reported $30.7 billion in total assets and a net loss of $784 million for the third quarter. From the second to the third quarter 2007, its estimated insured deposits rose $3.27 billion, from $9.72 billion to $12.99 billion. Together, estimated insured deposits at the two subsidiary institutions rose approximately $3.4 billion from quarter to quarter. However, given total industry estimated insured deposits as of the end of the third quarter of $4.24 trillion (the denominator of the deposit insurance fund reserve ratio), the effect of this increase on the reserve ratio was negligible.

In other words, the losses reported by Merrill Lynch did not have a meaningful effect on the Deposit Insurance Fund. Losses at an insured institution raise concerns, but do not directly affect the balance of the deposit insurance fund. Only an institution's actual failure or probable failure (which requires the FDIC to maintain a contingent loss reserve) directly affects that balance.

Thank you for your interest in this matter. If I can provide additional information, please do not hesitate to contact me or Eric Spitler, Director of Legislative Affairs, at 898-3837.

Sincerely,

Martin J. Gruenberg